

## EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

### CHAPTER 4--EMPLOYEE PLANS COMPLIANCE RESOLUTION SYSTEM

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#### **EMPLOYEE PLANS**

TECHNICAL

INTERNAL REVENUE SERVICE  
TAX EXEMPT AND GOVERNMENT ENTITIES

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## **EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001**

### **I. INTRODUCTION**

The Internal Revenue Service is responsible for administering the provisions of the Code relating to qualified plans and 403(b) plans. The Tax Exempt and Government Entities Division of the Service has established a system of programs designed to enable an employer that maintains a plan that has experienced a problem with an applicable Code requirement, to correct the problem and simultaneously preserve the tax benefits available for employers and employees. The system is called the Employee Plans Compliance Resolution System ("EPCRS").

EPCRS is based on the following general principles:

- Sponsors of retirement plans should be encouraged to establish administrative practices and procedures that ensure the plans are operated in accordance with Code requirements.
- Sponsors should make voluntary and timely correction of any plan failures.
- Voluntary compliance is promoted by providing for limited fees for voluntary corrections approved by the Service
- Sanctions for plan failures identified on audit should be reasonable in light of the nature, extent, and severity of the failure.
- Administration of EPCRS should be consistent and uniform.
- Taxpayers should be able to rely on the availability of EPCRS in taking corrective action to maintain their plans.

The components of EPCRS are the Administrative Policy Regarding Self-Correction ("APRSC"), the Voluntary Compliance Resolution ("VCR") program which includes the Standardized VCR Procedure ("SVP"), the Walk-in Closing Agreement Program ("Walk-in CAP"), the Audit Closing Agreement Program ("Audit CAP") and the Tax Sheltered Annuity Voluntary Correction ("TVC") program.

This chapter discusses Revenue Procedure 2000-16, 2000-6 I.R.B. 518, the most recent published guidance applicable to EPCRS.

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### II. REVENUE PROCEDURES APPLICABLE TO EPCRS

Revenue Procedure 98-22, 1998-12 I.R.B. 11 created EPCRS by consolidating previously established correction programs, including APRSC, VCR, Walk-in CAP, and Audit CAP into one document. Revenue Procedure 99-13, 1999-5 I.R.B. 52 applied EPCRS to TVC.

Further guidance under EPCRS was issued in **Revenue Procedure 99-31**, 1999-34 I.R.B. 280. Rev. Proc. 99-31 described and illustrated correction methods that plan sponsors could use to correct certain operational failures to comply with the qualified plan rules.

The most recent guidance, **Revenue Procedure 2000-16**, modifies Rev. Proc. 98-22. The modifications to Rev. Proc. 98-22 include:

- (1) incorporating Rev. Proc. 99-13, which applies EPCRS to 403(b) plans;
- (2) adding a new Appendix B which incorporates the correction methods described in Rev. Proc. 99-31 and
- (3) (3) redesignating Appendix B of Rev. Proc. 98-22 as Appendix C. More detail is set forth below.

### III. REVENUE PROCEDURE 2000-16

#### A. Background

The primary purpose of Rev. Proc. 2000-16 is to consolidate and coordinate the guidance previously published with respect to EPCRS. It is anticipated that the consolidated EPCRS revenue procedure will be updated on an annual basis to reflect changes published during the preceding calendar year.

Rev. Proc. 2000-16 contains certain clarifications that do not involve significant substantive modification of EPCRS as set forth in Rev. Procs. 98-22 and 99-13. The clarifications generally reflect the current practice under EPCRS. The correction and earnings adjustment methods and related examples set forth in Rev. Proc. 99-31 were

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incorporated without change in Appendix B.

### B. Clarifications

Rev. Proc 2000-16 contains the following clarifications

- Application of FICA and FUTA (sections 3.01 and 3.02) – if correction is made in accordance with the requirements of Rev. Proc. 2000-16, then, for purposes of applying FICA and FUTA, a 401(a) plan will be treated as a qualified plan, and annuity contracts or custodial accounts under a 403(b) plan will be treated as satisfying section 403(b).

Thus, correcting failures under a 401(a) plan or 403(b) plan pursuant to Rev. Proc. 2000-16 generally preserves tax benefits for employees (e.g., a plan is not treated as losing its tax favored status as a result of the failures, both for income and FICA and FUTA tax purposes).

For example, if a 401(a) plan is corrected under EPCRS, employer contributions to the plan, which are not subject to FICA, will not become subject to FICA solely on account of the failure. Note that with respect to a 403(b) plan, however, FICA and FUTA do apply with respect to excess amounts (i.e., amounts in excess of the section 415 limit or section 403(b)(2) exclusion allowance).

- Waiver of excise tax under section 4974 of the Code (section 6.04(3))- in appropriate cases, a waiver of the excise tax for minimum required distribution failures may be granted under the VCR, Walk-in CAP and TVC programs. See Attachment A of this chapter for a memo setting forth the procedures with respect to granting a waiver under the VCR, Walk-in-CAP and TVC programs.
- Statute of Limitations (section 6.02) – if correction is made for a closed taxable year, the employer's tax liability associated with that year will not be redetermined solely because of the correction. This makes clear requiring a correction for a closed year does not open the statute of limitations for that year.
- APRSC—factors to determine insignificant failures (section 8.02) – the eligibility requirements for self-correction of insignificant failures are clarified to confirm that the APRSC program is available to correct insignificant defects

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in plans of all sizes. Insignificance is determined by taking into account the factors relevant to a particular case; no single factor is determinative. Thus, the factors related to ratio percentages of affected participants (factors (4) and (5)) should not, in and of themselves, preclude small businesses from self-correcting insignificant failures.

- TVC—operational failures (section 5.02(2)(c)) – failures concerning the right to elect a direct rollover and to satisfy the limit on elective deferrals have been clarified. A direct rollover failure can be either a failure to give the employees the right to elect a direct rollover or a failure of the annuity contract or custodial agreement to provide for the direct rollover election. Similarly, a limit on elective deferral failure can be either a failure to satisfy the limit or a failure of the annuity contract or custodial agreement to provide the limit. For purposes of EPCRS, each of these failures is considered to be operational.
- VCR/Walk-in CAP-interrelated failures (section 10.02) – if the plan failures include failures correctable under VCR and failures correctable under Walk-in CAP, (e.g., interrelated operational and document failures), the employer may include all such failures in a submission under Walk-in CAP.

### **C. Explanations pertaining to Appendix B**

- SVP-failures and correction methods (section 10.11) – The failures and correction methods set forth in Appendix B, other than the correction methods that permit a retroactive amendment, are treated as eligible for SVP.
- For qualified plans, Rev. Proc. 2000-16 prescribes specific treatment for Excess Amounts (section 5.01(3)) and Overpayments (section 2.05 of Appendix B) – An Excess Amount means
  - (a) an Overpayment,
  - (b) an elective deferral or employee after-tax contribution returned to satisfy section 415 of the Code,
  - (c) an elective deferral in excess of the limitation of section 402(g) of the Code that is distributed,
  - (d) an excess contribution or excess aggregate contribution that is distributed to satisfy sections 401(k), 401(m) of the Code or

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- (e) any similar amount required to be distributed in order to maintain plan qualification.

An Overpayment means a distribution to an employee or beneficiary that exceeds the employee's or beneficiary's benefit under the terms of the plan because of a failure to comply with plan terms that implement sections 401(a)(17), 401(m) (but only with respect to the forfeiture of nonvested matching contributions that are excess aggregate contributions), 411(a)(3)(G), or 415 of the Code.

An Overpayment does not include a distribution of an Excess Amount described in (b), (c), (d), or (e) of the preceding paragraph.

An Excess Amount (other than an Overpayment) is an amount that has been contributed or allocated to a participant's account, which must be removed from the account in order to be corrected. An Overpayment is an amount in excess of a participant's benefit under the plan that has been distributed from the plan which must be returned to the plan to be considered corrected under Appendix B (see, e.g., section 2.04-Section 415 Failures).

An individual who received an Excess Amount must be notified that the Excess Amount is not eligible for favorable tax treatment (including a rollover). In addition, if the Excess Amount distributed was an Overpayment, the employer also takes reasonable steps to have the Overpayment (with interest) returned to the plan.

Under Appendix B, to the extent the amount returned is less than the Overpayment (with interest), then the employer or another person contributes the difference to the plan.

For 403(b) plans, Rev. Proc. 2000-16 prescribes the same treatment for Excess Amounts as for Excess Amounts in qualified plans. An Excess Amount means, in the case of a 403(b) plan, any contributions or allocations that are in excess of the limits under sections 415 or 403(b)(2) of the Code. The treatment of Overpayments for qualified plans is not applicable

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to 403(b) plans because Appendix B does not apply to 403(b) plans.

### **D. Appendix A and Appendix B**

SVP failures and corrections are listed in Appendix A. Rev. Proc. 99-31 is in Appendix B.

Prior to Rev. Proc. 99-31, Appendix A provided the only correction methods for certain operational failures that could be corrected under SVP. Operational failures and correction methods under Appendix B are treated as eligible for SVP, except for two correction methods using retroactive amendments (see the correction methods for correcting certain 401(a)(17) and hardship failures in Appendix B section 2.07-Correction by Amendment Under Walk-in CAP). Those correction methods are available under Walk-in CAP.

The correction methods set forth in Appendix A and Appendix B are strictly construed and are the only acceptable correction methods for failures corrected under SVP. If a plan sponsor wishes to modify a correction method or propose another correction method, the plan sponsor may not use SVP but may use one of the other programs such as VCR.

In addition to SVP and VCR, Appendix A can be used for corrections under APRSC, TVC and Walk-in CAP. Appendix B, however, is applicable for corrections under SVP, VCR, APRSC and Walk-in CAP but not TVC.

### **E. Appendix B**

Appendix B provides sample correction methods for certain operational failures. The correction methods provided in Appendix B are not the exclusive methods acceptable for the failures listed; a plan sponsor is permitted to use correction methods other than those provided in Appendix B.

Unless specifically noted otherwise, corrective contributions, allocations and distributions must be adjusted for earnings. Appendix B provides earnings



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adjustment methods for corrective contributions and allocations. Appendix B also provides rules of administrative convenience for plan sponsors under several of the correction methods.

### **1. CORRECTION METHODS**

Following is a summary of the correction methods. Examples of the correction methods are included in Appendix B.

#### **a. ADP/ACP Failures –**

Appendix A provides a correction method for an ADP, ACP or multiple use failure. The correction method requires the employer to make **Qualified Non-elective Contributions** (“QNECs”) to all eligible non-highly compensated employees in an amount equal to:

the same flat dollar amount or

the same percentage of compensation

necessary to raise the ADP or ACP of the non-highly compensated employees to the percentage needed to pass the test or tests.

In addition to Appendix A, Appendix B provides a method of correction for an ADP, ACP or multiple use failure: **the one-to-one method**.

Under the one-to-one method, the excess contribution amount, adjusted for earnings, is distributed to the highly compensated employees or to the extent the amount was forfeitable as of the close of the plan year of the failure, is forfeited.

The same amount that is distributed or forfeited is contributed to the plan by the employer to be allocated to eligible non-highly compensated employees.

The excess contribution amount for the year is equal to the excess of

- (i) the sum of the **excess contributions** (as defined in section 401(k)(8)(B) of the Code, **the excess aggregate contributions** (as defined in section 401(m)(6)(B)), **and the amount treated as**

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**excess contributions or excess aggregate contributions** under the multiple use test pursuant to section 401(m)(9) of the Code and section 1.401(m)-2(c) of the Regulations for the year, as assigned to each highly compensated employee in accordance with sections 401(k)(8) and (m)(8)(C), over

- (ii) previous corrections that complied with sections 401(k)(8), (m)(6) and (m)(9) (see Notice 97-2, 1997-1 C.B. 348).

Amounts that have been distributed as a result of prior unsuccessful attempts to correct an ADP, ACP or multiple use failure reduce the excess contribution amount for purposes of one-to-one. For administrative convenience, Appendix B also provides three choices for determining the eligible non-highly compensated employees who will share in the allocation of the amount contributed.

### **b. Exclusion of Eligible Employees in a 401(k) or (m) Plan**

Appendix A provides a correction method for the exclusion of an eligible employee from 401(k) or (m) plan for one or more plan years.

The correction method requires the employer to make a contribution for the excluded employee based on the ADP and/or ACP of the employee's group (highly compensated or non-highly compensated) and the employee's compensation. Under the correction method, the plan may not be disaggregated or restructured.

Appendix B expands the SVP correction method to include correction for the exclusion of an eligible employee from contributions under a 401(k) or (m) plan for a partial year. Under this method, the employer makes a contribution for the excluded employee based on:

the ADP/ACP of the employee's group

and the employee's compensation for the portion of the year the employee was excluded.

For administrative convenience, instead of using actual compensation for the portion of the year the employee was excluded, a pro rata portion of compensation for the year may be used. Additionally, the employer may take into account any contributions made on behalf of the employee for

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the year when determining the amount required to be contributed for the employee.

If an **employee** had the opportunity to make elective deferrals for at least 9 months of the year, under a special rule, the employer is not required to make a contribution with respect to elective deferrals on behalf of such employee.

However, the employer is required to make a contribution with respect to matching contributions and after-tax employee contributions to the extent applicable.

### **c. Exclusion of Eligible Employees in a Profit-Sharing Plan –**

The correction method in Appendix A for the exclusion of eligible employees in a profit sharing plan requires the employer to contribute on behalf of excluded employees an amount that is equal to the same percentage of compensation that was allocated under the plan's allocation formula to non-excluded employees.

In addition, Appendix B provides for a reallocation correction method that permits an employer to reduce the accounts of other employees to provide for the appropriate allocation for the excluded employee.

In certain cases, the employer does not have to adjust the accounts for earnings where, for example, most of the employees with account balances being reduced are non-highly compensated employees. For administrative convenience, rules are provided to determine how the amounts taken from employees' accounts are adjusted for earnings.

### **d. Vesting Failures**

The correction method for a failure to apply the correct vesting percentage in a defined contribution plan **that results in a forfeiture of an employee's account balance** may be corrected by the employer making a contribution on behalf of the employee in the amount of the amount previously forfeited. Additionally, the employer may use the reallocation correction method similar to the reallocation correction method for the exclusion of eligible employees in a profit-sharing plan.

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The same administrative convenience rules for determining how the amounts taken from employees' accounts are adjusted for earnings also apply when correcting a vesting failure under the reallocation method.

### **e. Failures Relating to a Section 415(b) Excess**

Appendix B provides two correction methods for a failure to satisfy the section 415(b) limit.

One correction method, the return of overpayment correction method, requires the employer to take reasonable steps to have the employee return the excess amount with appropriate interest. Appropriate interest does not necessarily mean that interest must be based on the plan's interest rate. Appropriate interest may be determined taking into account the facts and circumstances surrounding the distribution, including the circumstances of the employee.

To the extent the overpayment with appropriate interest is not returned or, if returned, the appropriate interest does not equal the plan's interest rate, the employer or another person contributes the amount necessary to put the plan in the position it would have been but for the distribution.

The second correction method, the adjustment of future payments correction method, applies in cases where the employee is in pay status receiving periodic payments, and may be used in lieu of the return of overpayment correction method.

Under this method, future payments to the employee may be reduced to recover the overpayment to the employee. If the employee is receiving payments in the form of a joint and survivor annuity, the overpayment must be recouped from the payments during the employee's life. Any reduction to recoup the payments from the employee may not reduce the spouse's survivor benefit.

### **f. Failures Relating to a Section 415(c) Excess**

Appendix A provides a correction method for a failure to satisfy the 415(c) limit in a defined contribution plan when the excess amount has not been distributed to an employee. Appendix B provides two correction methods for a failure to satisfy the 415(c) limit in a defined contribution plan when

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distributions have been made to an employee.

One correction method, the return of overpayment correction method, is similar to the method described above for correcting 415(b) excess payments. Under this method, the employer takes reasonable steps to have the employee return the overpayment with appropriate interest to the plan.

To the extent that the overpayment with appropriate interest is not returned, the employer or another person contributes the amount to the plan. That amount is placed in a suspense account and used to reduce future employer contributions.

The second correction method, the forfeiture correction method, applies in limited circumstances to non-highly compensated employees covered under a 401(k)/(m) plan who terminated with no vested interest in matching and nonelective contributions remaining in the plan (and has not been reemployed at the time of the correction).

Instead of requesting the employee to return the overpayment from the amount distributed, the 415(c) excess is deemed to consist solely of the matching and nonelective contributions remaining in the plan. That amount is placed in a suspense account and used to reduce future employer contributions.

### **g. Other Overpayment Failures –**

The correction methods described for section 415 excess payments may be used to correct other overpayment failures.

### **h. 401(a)(17) Failures**

Appendix B provides two methods to correct a failure to limit contributions to the section 401(a)(17) compensation limit under a defined contribution plan.

One correction method, the reduction of account balance method, is acceptable for VCR, SVP and APRSC. Under this method, the improperly allocated employer contribution (plus earnings) reduces the account

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balance of an employee who received an allocation of employer contributions on the basis of compensation in excess of the section 401(a)(17) limit. The amount is either reallocated to the other participants, or placed in a suspense account to be used to reduce future employer contributions.

**The second correction method**, the contribution correction method, is available under Walk-in CAP and Audit CAP. This method permits a plan amendment to increase the contribution percentage for all employees equal to the highest percentage received by an employee with an excess (other than employees for whom there was a 401(a)(17) failure).

### **i. Hardship Distribution Failures**

Appendix B provides a plan amendment correction method that is available to correct the operational failure of making hardship distributions under a plan that does not provide for hardship distributions.

This method is available under Walk-in CAP and Audit CAP, as it requires a retroactive plan amendment to provide for hardship distributions. The amendment must satisfy certain discrimination and qualification requirements that would have been applicable had the amendment been adopted when hardship distributions were first made available.

## **2. EARNINGS ADJUSTMENT METHODS**

An employer may use the earnings adjustment methods described in Appendix B to adjust a corrective contribution or allocation, including those made pursuant to Appendix A and Appendix B, for earnings in a defined contribution plan.

The earnings adjustment methods may be used for corrective distributions in appropriate circumstances, but the employer does not get reliance under the Rev. Proc. Rules of administrative convenience for purposes of determining the period of the failure for which earnings adjustment is required and for determining the earnings rate are also provided.

Following is a summary of the four earnings adjustment methods. Under the earnings adjustment methods, a corrective contribution or allocation that increases an employee's account

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balance is adjusted to reflect an “earnings amount” that is based on the earning(s) rate for the period of the failure. The earnings rate generally is based on the investment results that would have applied to the corrective contribution or allocation if the failure had not occurred. Other earnings adjustment methods may also be appropriate. Examples of the earnings adjustment methods are provided in Appendix B.

- a. Plan Allocation Method – Under this method, the earnings amount is allocated in accordance with the plan’s method of allocating earnings.
- b. Specific Employee Allocation Method – Under this method the entire earnings amount is allocated solely to the account of the employee on whose behalf the corrective contribution or allocation is made. Rules are provided to determine the appropriate valuation periods.
- c. Bifurcated Allocation Method – Under this method, the earnings amount for the valuation periods prior to correction are allocated to the employee on whose behalf the corrective contribution or allocation is made. The earnings amount for the valuation period during which the corrective contribution or allocation is made is allocated in accordance with the plan’s method for allocating earnings.
- d. Current Period Allocation Method – Under this method, the earnings amount attributable to partial valuation periods (the period when the defect occurred and the period when the defect is corrected) are allocated in accordance with the plan’s method for allocating earnings. The earnings for full valuation periods between the partial valuation periods are allocated to the employee on whose behalf the corrective contribution or allocation is made.

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### **PUBLISHED GUIDANCE-Rev. Proc. 2000-16**

26 CFR 601.202: Closing agreements.

2000-6 I.R.B. 518; REV. PROC. 2000-16

February 7, 2000

### **PART I. INTRODUCTION TO EMPLOYEE PLANS COMPLIANCE RESOLUTION SYSTEM**

#### **SECTION 1. PURPOSE AND OVERVIEW**

##### **.01 PURPOSE.**

This revenue procedure updates and consolidates the comprehensive system of correction programs for sponsors of retirement plans that are intended to satisfy the requirements of § 401(a), § 403(a) or § 403(b) of the Internal Revenue Code (the "Code"), but that have not met these requirements for a period of time. This system, the Employee Plans Compliance Resolution System ("EPCRS"), permits plan sponsors to correct these Qualification or § 403(b) Failures and thereby continue to provide their employees with retirement benefits on a tax-favored basis. The components of EPCRS are the Administrative Policy Regarding Self-Correction ("APRSC"), the Voluntary Compliance Resolution ("VCR") program, the Walk-in Closing Agreement Program ("Walk-in CAP"), the Audit Closing Agreement Program ("Audit CAP") and the Tax Sheltered Annuity Voluntary Correction ("TVC") program.

##### **.02 REVISIONS.**

This revenue procedure modifies Rev. Proc. 98-22, 1998-12 I.R.B. 11, which consolidated the correction programs into EPCRS. The modifications to Rev. Proc. 98-22 include:



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- (1) incorporating Rev. Proc. 99-13, 1999-5 I.R.B. 52, which applies EPCRS to 403(b) Plans;
- (2) adding a new Appendix B which incorporates the correction methods described and illustrated in Rev. Proc. 99-31 1999-34 I.R.B. 280;
- (3) redesignating Appendix B of Rev. Proc. 98-22 as Appendix C; and (4) reflecting the new Tax Exempt and Government Entities Division (TE/GE) of the IRS.

### **.03 GENERAL PRINCIPLES UNDERLYING EPCRS. EPCRS IS BASED ON THE FOLLOWING GENERAL PRINCIPLES:**

- Sponsors of tax-qualified retirement plans or 403(b) Plans should be encouraged to establish administrative practices and procedures that ensure that plans are operated properly in accordance with the tax qualification or 403(b) requirements.
- Sponsors of tax-qualified retirement plans should maintain plan documents satisfying the tax qualification requirements.
- Plan sponsors should make voluntary and timely correction of any Qualification or 403(b) Failures, whether involving discrimination in favor of highly compensated employees, plan operations, or the terms of the plan document. Timely and efficient correction protects participating employees by providing them with their expected retirement benefits, including favorable tax treatment.
- Voluntary compliance is promoted by providing for limited fees for voluntary corrections approved by the Service, thereby reducing employers' uncertainty regarding their potential tax liability and participants' potential income tax liability.
- Sanctions for Qualification or 403(b) Failures identified on audit should be reasonable in light of the nature, extent, and severity of the violation.
- Administration of EPCRS should be consistent and uniform.
- Taxpayers should be able to rely on the availability of EPCRS in taking corrective actions to maintain the qualified or 403(b) status of their plans.

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### **.04 OVERVIEW. EPCRS INCLUDES THE FOLLOWING BASIC ELEMENTS:**

- Self-correction. A plan sponsor that has established compliance practices and procedures may, at any time, correct insignificant Operational Failures without paying any fee or sanction. In addition, in the case of a Qualified Plan that is the subject of a favorable determination letter from the Service or of a 403(b) Plan, the plan sponsor generally may correct even significant Operational Failures within a two-year period without payment of any fee or sanction. (APRSC)
- Voluntary correction with Service approval. In the case of any other Qualification or 403(b) Failure, a plan sponsor, at any time before audit, may pay a limited fee and receive the Service's approval for the correction. (VCR, Walk-in CAP, and TVC)
- Correction on audit. If a Qualification or 403(b) Failure (other than a failure corrected as described above) is identified on audit and corrected, the sanction imposed will bear a reasonable relationship to the nature, extent and severity of the failure, taking into account the extent to which correction occurred before audit. (Audit CAP)

### **.05 FUTURE ENHANCEMENTS.**

The primary purpose of this revenue procedure is to consolidate in a single document, for ease of use and reference, the guidance previously published with respect to EPCRS. Certain clarifications and revisions, discussed below, that do not involve significant substantive modification of EPCRS and that generally reflect the current practice under EPCRS, are included in this revenue procedure.

The Service and Treasury are actively reviewing the comments that have been received on EPCRS that are not reflected in this revenue procedure. These additional enhancements will be incorporated into upcoming guidance on EPCRS. In addition to that guidance, it is anticipated that the consolidated EPCRS revenue procedure will be updated on an annual basis to reflect changes published during the preceding calendar year.

## **SECTION 2. EFFECT ON PROGRAMS**

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### **.01 EFFECT ON PROGRAMS.**

This revenue procedure affects the programs as follows:

- consolidates and coordinates guidance issued in 1998 and 1999 into a unified EPCRS procedure;
- clarifies the application of FICA and FUTA taxes (and corresponding withholding obligations) to corrected Qualified Plans and 403(b) Plans; and
- clarifies that the statute of limitations for purposes of redetermining taxes for a closed taxable year will not be reopened solely because of correction of a failure that occurred in such year.

### **.02 EFFECT ON SPECIFIC PROGRAMS. THIS REVENUE PROCEDURE AFFECTS THE SPECIFIC PROGRAMS AS FOLLOWS:**

- (1) APRSC. APRSC enables a sponsor of a Qualified Plan or a 403(b) Plan to self-correct Operational Failures it discovers in its plans. The provisions of APRSC are modified and restated to:

clarify and confirm, under the eligibility requirements for APRSC, that the program is available to correct insignificant defects in plans of all sizes.
- (2) VCR. The VCR program enables a sponsor of a Qualified Plan to voluntarily disclose to the Service Operational Failures it has discovered in its plans and to pay a fixed fee to the Service. The provisions of VCR are modified to:
  - grant, in appropriate cases, a waiver of the excise tax under § 4974 for minimum required distribution failures that are corrected by the Plan Sponsor under VCR;
  - amplify the permissible correction methods under the Standardized VCR Program (SVP) (see Appendix A and Appendix B of this revenue procedure); and
  - clarify that sponsors may use Walk-in CAP for interrelated VCR and Walk-in CAP failures.
- (3) Walk-in CAP. Walk-in CAP enables a sponsor of a Qualified Plan to voluntarily disclose to the Service Qualification Failures it has discovered in its plan and to pay a compliance correction fee. The provisions of Walk-in CAP are modified to:

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grant, in appropriate cases, a waiver of the excise tax under § 4974 for minimum distribution failures that are corrected by the Plan Sponsor under Walk-in CAP.

(4) TVC. Similar to Walk-in CAP, TVC enables an employer that offers a 403(b) Plan to voluntarily disclose to the Service 403(b) Failures it has discovered in its plan and to pay a compliance correction fee. The provisions of TVC are modified to:

- grant, in appropriate cases, a waiver of the excise tax under § 4974 for minimum distribution failures that are corrected by the Plan Sponsor under TVC.
- clarify the types of failures that may be corrected under TVC.

## **PART II. PROGRAM EFFECT AND ELIGIBILITY**

### **SECTION 3. EFFECT OF EPCRS; RELIANCE**

#### **.01 EFFECT OF EPCRS ON QUALIFIED PLANS.**

If the eligibility requirements of section 4 are satisfied and the Plan Sponsor corrects a Qualification Failure in accordance with the requirements of APRSC in section 7, the VCR program in section 10, Walk-in CAP in section 11, or Audit CAP in section 14, the Service will not treat the Qualified Plan as disqualified on account of the Qualification Failure. If the Plan Sponsor corrects the failures in accordance with the requirements of this revenue procedure the plan will be treated as a qualified plan for purposes of applying § 3121(a)(5) (FICA taxes) and for purposes of applying § 3306(a)(5) (FUTA taxes).

#### **.02 EFFECT OF EPCRS ON 403(B) PLANS.**

If the applicable eligibility requirements are satisfied and the employer corrects a failure in accordance with the requirements of APRSC, TVC, or Audit CAP for 403(b) Plans, the Service will not pursue income inclusion for affected participants, or liability for income tax withholding, on account of the failure. However, the correction of a failure may result in income tax consequences to participants (for example, participants may be required to include in gross income

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distributions of Excess Amounts in the year of distribution). In addition, if these requirements are met and correction is made under this revenue procedure, the annuity contracts or custodial accounts under a 403(b) Plan will be treated as annuity contracts described in § 403(b) for purposes of applying § 3121(a)(5) (FICA taxes) and for purposes of applying § 3306(a)(5) (FUTA taxes). However, contributions or allocations of Excess Amounts are generally treated as wages for purposes of FICA and FUTA taxes.

### **.03 OTHER TAXES AND PENALTIES.**

See section 6.04 for rules relating to other taxes and penalties.

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### **.04 RELIANCE.**

Taxpayers may rely on this revenue procedure, including the relief described in sections 3.01 and 3.02.

## **SECTION 4. PROGRAM ELIGIBILITY**

### **.01 PROGRAM ELIGIBILITY FOR QUALIFIED PLANS.**

EPCRS includes three specific voluntary correction programs and an audit correction program for Qualified Plans. The voluntary correction programs are APRSC and VCR, both of which are available for Operational Failures, and Walk-in CAP, which applies to Plan Document and Demographic Failures and to Operational Failures that are not eligible for APRSC and VCR. APRSC is a voluntary employer-initiated procedure that generally does not involve Service approval, whereas VCR and Walk-in CAP are voluntary employer-initiated procedures that involve Service approval. The audit correction program is Audit CAP, which is available for all types of Qualification Failures found on examination that cannot be corrected under APRSC.

### **.02 PROGRAM ELIGIBILITY FOR 403(B) PLANS.**

EPCRS includes two specific voluntary correction programs and an audit correction program for 403(b) Plans. The voluntary correction programs are APRSC and TVC. APRSC is available only for Operational Failures, and is not available to correct Eligibility or Demographic Failures. APRSC is available to correct Excess Amounts using the method described in section 6.02(4)(b)(i) below, but not the method described in section 6.02(4)(b)(ii) below. There is no requirement that an employer obtain a private letter ruling from the Service covering its 403(b) Plan in order to be eligible for APRSC. TVC is a voluntary program that involves Service approval. TVC applies to Eligibility, Demographic, and Operational Failures that are within the jurisdiction of Employee Plans, including Plans of Ineligible Employers. The audit correction program is Audit CAP, which is also available for Eligibility, Demographic, and Operational Failures found on examination that cannot be corrected under APRSC.

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### **.03 EFFECT OF EXAMINATION.**

If the plan or Plan Sponsor is Under Examination, the VCR, Walk-in CAP, and TVC programs are not available; insignificant Operational Failures can be corrected under APRSC; and significant Operational Failures can be corrected under APRSC in limited circumstances. See section 9.

### **.04 FAVORABLE LETTER REQUIREMENT.**

The VCR program and the provisions of APRSC relating to significant Operational Failures (see section 9) of a Qualified Plan are available only for a plan that is the subject of a Favorable Letter.

### **.05 ESTABLISHED PRACTICES AND PROCEDURES.**

In order to be eligible for APRSC, the Plan Sponsor or administrator of a plan must have established practices and procedures (formal or informal) reasonably designed to promote and facilitate overall compliance with the requirements of § 401(a) or § 403(b). For example, the plan administrator of a Qualified Plan might use a check sheet for tracking allocations and indicate on that check sheet whether a particular employee was a key employee for top-heavy purposes. A plan document alone will not constitute evidence of established procedures. These established procedures must have been in place and routinely followed, but through an oversight or mistake in applying them, or because of an inadequacy in the procedures, an Operational Failure occurred. A 403(b) plan document is neither necessary nor sufficient to demonstrate that the employer, plan administrator, insurer or account custodian has in place established practices and procedures reasonably designed to facilitate overall compliance.

### **.06 QUALIFIED PLAN AMENDMENTS.**

- (1) Correction by plan amendment not permitted in APRSC or VCR. Neither APRSC nor the VCR program is available for a Plan Sponsor to correct an Operational Failure by a plan amendment that conforms the terms of the plan to the plan's prior operations. Thus, if loans were made to participants, but the plan document did not permit loans to be made to participants, the failure cannot be corrected under VCR by retroactively amending the plan to provide for the loans. Nevertheless, if a Plan Sponsor corrects under APRSC or VCR, it may

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amend the plan to the extent necessary to reflect operational correction. For example, if the plan failed to satisfy the ADP test required under § 401(k)(3) and the employer must make qualified nonelective contributions not already provided for under the plan, the plan may be amended to provide for qualified nonelective contributions. The issuance of a compliance statement does not constitute a determination as to the effect of any plan amendment on the qualification of the plan.

- (2) Availability of correction by plan amendment in Walk-in CAP. A Plan Sponsor may use Walk-in CAP for a Qualified Plan to correct an Operational Failure by a plan amendment to conform the terms of the plan to the plan's prior operations, provided that the amendment complies with the requirements of § 401(a), including the requirements of §§ 401(a)(4), 410(b), and 411(d)(6).

### **.07 EGREGIOUS FAILURES.**

Neither APRSC nor the VCR program is available to correct Operational Failures that are egregious. For example, if an employer has consistently and improperly covered only highly compensated employees or if a contribution to a defined contribution plan for a highly compensated individual is several times greater than the dollar limit set forth in § 415, the failure would be considered egregious. Walk-In CAP and TVC are available to correct egregious failures; however, these failures are subject to the fees described in sections 13.05(3) and 13.06(6).

### **.08 DIVERSION OR MISUSE OF PLAN ASSETS.**

The APRSC, VCR, Walk-in CAP, TVC and Audit CAP programs are not available for correcting Qualification or 403(b) Failures relating to the diversion or misuse of plan assets.

## **PART III. DEFINITIONS, CORRECTION PRINCIPLES, AND RULES OF GENERAL APPLICABILITY**

### **SECTION 5. DEFINITIONS**

The following definitions apply for purposes of this revenue procedure:



**.01 DEFINITIONS FOR QUALIFIED PLANS.**

The definitions in this section 5.01 apply to Qualified Plans.

**1. QUALIFIED PLAN.**

The term "Qualified Plan" means a plan intended to satisfy the requirements of § 401(a) or § 403(a).

**2. QUALIFICATION FAILURE.**

A Qualification Failure is any failure that adversely affects the qualification of a plan. There are three types of Qualification Failures:

- (a) Plan Document Failures,
- (b) Operational Failures, and
- (c) Demographic Failures.

**A. PLAN DOCUMENT FAILURE.**

The term "Plan Document Failure" means a plan provision (or the absence of a plan provision) that, on its face, violates the requirements of § 401(a) or § 403(a). Thus, for example, the failure of a plan to be amended to reflect a new qualification requirement within the plan's applicable remedial amendment period under § 401(b) is a Plan Document Failure. For purposes of this revenue procedure, a Plan Document Failure includes any Qualification Failure that is a violation of the requirements of § 401(a) or § 403(a) and that is neither an Operational Failure nor a Demographic Failure.

**B. OPERATIONAL FAILURE.**

The term "Operational Failure" means a Qualification Failure that arises solely from the failure to follow plan provisions.

A failure to follow the terms of the plan providing for the satisfaction of the requirements of § 401(k) and § 401(m) is considered to be an Operational Failure. A plan does not have an Operational Failure to the extent the plan is permitted to be

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amended retroactively pursuant to § 401(b) or another statutory provision to reflect the plan's operations. However, if within an applicable remedial amendment period under § 401(b), a plan has been properly amended for statutory or regulatory changes, and, on or after the later of the date the amendment is effective or is adopted, the amended provisions are not followed, then the plan is considered to have an Operational Failure.

### C. DEMOGRAPHIC FAILURE.

The term "Demographic Failure" means a failure to satisfy the requirements of § 401(a)(4), § 401(a)(26), or § 410(b) that is not an Operational Failure.

The correction of a Demographic Failure generally requires a substantive corrective amendment to the plan adding more benefits or increasing existing benefits (cf., § 1.401(a)(4)-11(g) of the Income Tax Regulations).

### **3. EXCESS AMOUNT.**

The term "Excess Amount" means (a) an Overpayment, (b) an elective deferral or employee after-tax contribution returned to satisfy § 415, (c) an elective deferral in excess of the limitation of § 402(g) that is distributed, (d) an excess contribution or excess aggregate contribution that is distributed to satisfy § 401(k) or § 401(m), or (e) any similar amount required to be distributed in order to maintain plan qualification.

### **4. FAVORABLE LETTER.**

The term "Favorable Letter" means a current favorable determination letter for an individually designed plan (including a volume submitter plan), a current favorable opinion letter for a Plan Sponsor that has adopted a master or prototype plan, or a current favorable notification letter for a Plan Sponsor that has adopted a regional prototype plan. A plan has a current favorable determination letter, opinion letter, or notification letter if either (a), (b), or (c) below is satisfied:

- (a) The plan has a favorable determination, opinion, or notification letter that considers the Tax Reform Act of 1986 ("TRA '86").
- (b) The plan is a governmental plan or non-electing church plan described in Rev. Proc. 99-23, 1999-16 I.R.B. 5, and has a favorable determination, opinion, or notification letter that considers the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), the Deficit Reduction Act of 1984

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("DEFRA"), and the Retirement Equity Act of 1984 ("REA"), and the § 401(b) remedial amendment period for TRA '86 has not yet expired.

- (c) The plan is initially adopted or effective after December 7, 1994, and the Plan Sponsor timely submits an application for a determination, opinion, or notification letter within the plan's remedial amendment period under § 401(b).

### **5. MAXIMUM PAYMENT AMOUNT.**

The term "Maximum Payment Amount" means a monetary amount that is approximately equal to the tax the Service could collect upon plan disqualification and is the sum for the open taxable years of the:

- (a) tax on the trust (Form 1041),
- (b) additional income tax resulting from the loss of employer deductions for plan contributions (and any interest or penalties applicable to the Plan Sponsor's return), and
- (c) additional income tax resulting from income inclusion for participants in the plan (Form 1040).

For purposes of determining the maximum compliance correction fee applicable under section 13.05(3), relating to egregious failures under Walk-in CAP, paragraph (b) above is modified to exclude interest or penalties applicable to the Plan Sponsor's return, and paragraph (c) above is modified to include only the additional income tax resulting from income inclusion for highly compensated employees, as defined in § 414(q).

### **6. OVERPAYMENT.**

The term "Overpayment" means a distribution to an employee or beneficiary that exceeds the employee's or beneficiary's benefit under the terms of the plan because of a failure to comply with plan terms that implement § 401(a)(17), 401(m) (but only with respect to the forfeiture of nonvested matching contributions that are excess aggregate contributions), 411(a)(3)(G), or 415. An Overpayment does not include a distribution of an Excess Amount described in section 5.01(3) (b), (c), (d), or (e).

### **7. PLAN SPONSOR.**

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The term "Plan Sponsor" means the employer that establishes or maintains a qualified retirement plan for its employees.

### **.02 DEFINITIONS FOR 403(B) PLANS.**

The definitions in this section 5.02 apply to 403(b) Plans.

#### **1. 403(B) PLAN.**

The term "403(b) Plan" means a plan or program intended to satisfy the requirements of § 403(b), including a Plan of an Ineligible Employer.

#### **2. 403(B) FAILURE.**

A 403(b) Failure is any Operational, Eligibility or Demographic Failure as defined below.

##### **A. DEMOGRAPHIC FAILURE.**

The term "Demographic Failure" means a failure to satisfy the requirements of § 401(a)(4), § 401(a)(26), or § 410(b) (as applied to 403(b) Plans pursuant to § 403(b)(12)(A)(i)).

##### **b. ELIGIBILITY FAILURE.**

The term "Eligibility Failure" means any of the following:

- (i) A Plan of an Ineligible Employer;
- (ii) A failure to satisfy the nontransferability requirement of § 401(g);
- (iii) A failure to initially establish or maintain a custodial account as required by § 403(b)(7); or
- (iv) A failure to purchase (initially or subsequently) either an annuity contract from an insurance company (unless grandfathered under Rev. Rul. 82-102, 1982-1 C.B. 62) or a custodial account from a regulated investment company utilizing a bank or an approved non-bank trustee/custodian.

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### C. OPERATIONAL FAILURE.

The term "Operational Failure" means, with respect to a 403(b) Plan, any of the following:

- (i) A failure to satisfy the requirements of § 403(b)(12)(A)(ii) (relating to the availability of salary reduction contributions);
- (ii) A failure to satisfy the requirements of § 401(m) (as applied to 403(b) Plans pursuant to § 403(b)(12)(A)(i));
- (iii) A failure to satisfy the requirements of § 401(a)(17) (as applied to 403(b) Plans pursuant to § 403(b)(12)(A)(i));
- (iv) A failure to satisfy the distribution restrictions of § 403(b)(7) or § 403(b)(11);
- (v) A failure to satisfy the incidental death benefit rules of § 403(b)(10);
- (vi) A failure to pay minimum required distributions under § 403(b)(10);
- (vii) A failure to give employees the right to elect a direct rollover under § 403(b)(10), including the failure to give meaningful notice of such right;
- (viii) A failure of the annuity contract or custodial agreement to provide participants with a right to elect a direct rollover under §§ 403(b)(10) and 401(a)(31);
- (ix) A failure to satisfy the limit on elective deferrals under § 403(b)(1)(E);
- (x) A failure of the annuity contract or custodial agreement to provide the limit on elective deferrals under §§ 403(b)(1)(E) and 401(a)(30);
- (xi) A failure involving contributions or allocations of Excess Amounts; or
- (xii) Any other failure to satisfy applicable requirements under § 403(b) that (i) results in the loss of § 403(b) status for the plan or the loss of § 403(b) status for one or more custodial account(s) or annuity contract(s) under the plan and (ii) is not a Demographic Failure, an Eligibility Failure, or a failure related to the purchase of annuity contracts, or contributions to

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custodial accounts, on behalf of individuals who are not employees of the employer.

### **3. EXCESS AMOUNT.**

The term "Excess Amount" means, in the case of a 403(b) Plan, any contributions or allocations that are in excess of the limits under § 415 or § 403(b)(2)(the exclusion allowance limit) for the year.

### **4. PLAN OF AN INELIGIBLE EMPLOYER.**

The term "Plan of an Ineligible Employer" means a plan intended to satisfy the requirements of § 403(b) but which is not eligible for favorable tax treatment under § 403(b) because the employer is not a tax-exempt organization described in § 501(c)(3) or a public educational organization described in § 170(b)(1)(A)(ii).

### **5. PLAN SPONSOR.**

The term "Plan Sponsor" means the employer that offers a 403(b) Plan to its employees.

### **6. TOTAL SANCTION AMOUNT.**

The term "Total Sanction Amount" means a monetary amount that is approximately equal to the income tax the Service could collect as a result of the failure.

### **.03 UNDER EXAMINATION.**

This definition applies to Qualified Plans and 403(b) Plans. The term "Under Examination" means:

- (1) a plan that is under an Employee Plans examination (that is, an examination of a Form 5500 series or other Employee Plans examination), or
- (2) (2) a Plan Sponsor that is under an Exempt Organizations examination (that is, an examination of a Form 990 series or other Exempt Organizations examination).

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A plan that is under an Employee Plans examination includes any plan for which the Plan Sponsor, or a representative, has received verbal or written notification from Employee Plans of an impending Employee Plans examination, or of an impending referral for an Employee Plans examination, and also includes any plan that has been under an Employee Plans examination and is now in Appeals or in litigation for issues raised in an Employee Plans examination. A plan is considered to be Under Examination if it is aggregated for purposes of satisfying the nondiscrimination requirements of § 401(a)(4), the minimum participation requirements of § 401(a)(26), the minimum coverage requirements of § 410(b), or the requirements of § 403(b)(12), with a plan(s) that is Under Examination. In addition, a plan is considered to be Under Examination with respect to a failure of a qualification requirement (other than those described in the preceding sentence) if the plan is aggregated with another plan for purposes of satisfying that qualification requirement (for example, § 402(g), § 415, or § 416) and that other plan is Under Examination. For example, assume Plan A has a § 415 failure, Plan A is aggregated with Plan B only for purposes of § 415, and Plan B is Under Examination. In this case, Plan A is considered to be Under Examination with respect to the § 415 failure. However, if Plan A has a failure relating to the spousal consent rules under § 417 or the vesting rules of § 411, Plan A is not considered to be Under Examination with respect to the § 417 or § 411 failure. For purposes of this revenue procedure, the term aggregation does not include consideration of benefits provided by various plans for purposes of the average benefits test set forth in § 410(b)(2).

An Employee Plans examination also includes a case in which a Plan Sponsor has submitted a Form 5310, Application for Determination of Qualification Upon Termination, and the Employee Plans agent notifies the Plan Sponsor, or a representative, of possible Qualification Failures, whether or not the Plan Sponsor is officially notified of an "examination." This would include a case where, for example, a Plan Sponsor has applied for a determination letter on plan termination, and an Employee Plans agent notifies the Plan Sponsor that there are partial termination concerns.

A Plan Sponsor that is under an Exempt Organizations examination includes any Plan Sponsor that has received (or whose representative has received) verbal or written notification from Exempt Organizations of an impending Exempt Organizations examination or of an impending referral for an Exempt Organizations examination and also includes any Plan Sponsor that has been under an Exempt Organizations examination and is now in Appeals or in litigation for issues raised in an Exempt Organizations examination.

## **SECTION 6. CORRECTION PRINCIPLES AND RULES OF GENERAL APPLICABILITY**

### **.01 CORRECTION PRINCIPLES: RULES OF GENERAL APPLICABILITY.**

The following general correction principles and rules of general applicability apply for purposes of this revenue procedure.

### **.02 CORRECTION.**

Generally, a Qualification or 403(b) Failure is not corrected unless full correction is made with respect to all participants and beneficiaries, and for all taxable years (whether or not the taxable year is closed). Even if correction is made for a closed taxable year, the tax liability associated with that year will not be redetermined because of the correction. In the case of a Qualified Plan with an Operational Failure, correction is determined taking into account the terms of the plan at the time of the failure. Correction should be accomplished taking into account the following principles:

#### **1. RESTORATION OF BENEFITS.**

The correction method should restore the plan to the position it would have been in had the Qualification or 403(b) Failure not occurred, including restoration of current and former participants and beneficiaries to the benefits and rights they would have had if the Qualification or 403(b) Failure had not occurred.

#### **2. REASONABLE AND APPROPRIATE CORRECTION.**

The correction should be reasonable and appropriate for the Qualification or 403(b) Failure. Depending on the nature of the Qualification or 403(b) Failure, there may be more than one reasonable and appropriate correction for the failure. Any correction method permitted under Appendix A or Appendix B is deemed to be a reasonable and appropriate method of correcting the related Qualification Failure. Any correction method permitted under Appendix A applicable to a 403(b) Plan is deemed to be a reasonable and appropriate method of correcting the related 403(b) Failure. Whether any other particular correction method is reasonable and appropriate is determined taking into account the applicable facts and circumstances and the following principles:



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- (a) The correction method should, to the extent possible, resemble one already provided for in the Code, Income Tax Regulations, or other guidance of general applicability. For example, for Qualified Plans, the defined contribution plan correction methods set forth in § 1.415-6(b)(6) would be the typical means of correcting a failure under § 415. Likewise, the correction method set forth in § 1.402(g)-1(e)(2) would be the typical means of correcting a failure under § 402(g).
- (b) The correction method for Qualification or 403(b) Failures relating to nondiscrimination should provide benefits for nonhighly compensated employees. For example, for Qualified Plans, the correction method set forth in § 1.401(a)(4)-11(g) (rather than methods making use of the special testing provisions set forth in § 1.401(a)(4)-8 or § 1.401(a)(4)-9) would be the typical means of correcting a failure to satisfy nondiscrimination requirements. Similarly, the correction of a failure to satisfy the requirements of § 401(k)(3), 401(m)(2), or 401(m)(9) (relating to nondiscrimination) solely by distributing excess amounts to highly compensated employees would not be the typical means of correcting such a failure.
- (c) The correction method should keep plan assets in the plan, except to the extent the Code, regulations, or other guidance of general applicability provide for correction by distribution to participants or beneficiaries or return of assets to the employer or Plan Sponsor. For example, if an excess allocation (not in excess of the § 415 limits) made under a Qualified Plan was made for a participant under a plan (other than a cash or deferred arrangement), the excess should be reallocated to other participants or, depending on the facts and circumstances, used to reduce future employer contributions.
- (d) The correction method should not violate another applicable specific requirement of § 401(a) or § 403(b) (for example, § 401(a)(4), 411(d)(6) or 403(b)(12), as applicable). If an additional failure is created as a result of the use of a correction method in this revenue procedure, then that failure also must be corrected in conjunction with the use of that correction method and in accordance with the requirements of this revenue procedure.

### **3. CONSISTENCY REQUIREMENT.**

Generally, where more than one correction method is available to correct a type of Operational Failure for a plan year (or where there are alternative ways to apply a

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correction method), the correction method (or one of the alternative ways to apply the correction method) should be applied consistently in correcting all Operational Failures of that type for that plan year. Similarly, earnings adjustment methods generally should be applied consistently with respect to corrective contributions or allocations for a particular type of Operational Failure for a plan year.

### **4. TREATMENT OF EXCESS AMOUNTS.**

The following provisions apply for purposes of treating Excess Amounts under Qualified Plans and 403(b) Plans.

(a) Treatment of Excess Amounts under Qualified Plans. A distribution of an Excess Amount is not eligible for the favorable tax treatment accorded to distributions from Qualified Plans (such as eligibility for rollover under § 402(c)). To the extent that a current or prior distribution was a distribution of an Excess Amount, distribution of that Excess Amount is not an eligible rollover distribution. Thus, for example, if such a distribution was contributed to an individual retirement arrangement ("IRA"), the contribution is not a valid rollover contribution for purposes of determining the amount of excess contributions (within the meaning of § 4973) to the individual's IRAs. Where an Excess Amount has been distributed the employer must notify the recipient that (i) the Excess Amount was distributed and (ii) the Excess Amount was not eligible for favorable tax treatment accorded to distributions from Qualified Plans (and, specifically, was not eligible for tax-free rollover).

(b) Treatment of Excess Amounts under 403(b) Plans.

- (i) Distribution of Excess Amounts. Excess Amounts for a year, adjusted for earnings through the date of distribution, must be distributed to affected participants and beneficiaries and are includible in their gross income in the year of distribution. The distribution of Excess Amounts is not an eligible rollover distribution within the meaning of § 403(b)(8). A distribution of Excess Amounts is generally treated in the manner described in section 3 of Rev. Proc. 92-93, 1992-2 C.B. 505, relating to the corrective disbursement of elective deferrals. The distribution must be reported on Forms 1099-R for the year of distribution with respect to each participant or beneficiary receiving such a distribution. In addition, the employer must inform affected participants and beneficiaries that the distribution of Excess Amounts is not eligible for rollover. Excess Amounts distributed pursuant to this subparagraph (4)(b)(i) are not treated as amounts

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previously excludable under § 403(b)(2)(A)(ii) for purposes of calculating the maximum exclusion allowance for the taxable year of the distribution and for subsequent taxable years.

- (ii) **Retention of Excess Amounts.** Under TVC and Audit CAP, Excess Amounts will be treated as corrected (even though the Excess Amounts are retained in the 403(b) Plan) if the following requirements are satisfied. Excess Amounts arising from a § 415 failure, adjusted for earnings through the date of correction, must reduce affected participants' applicable § 415 limit for the year following the year of correction (or for the year of correction if the employer so chooses), and subsequent years, until the excess is eliminated. Excess Amounts (whether arising from a § 415 failure or a § 403(b)(2) failure), adjusted for earnings through the date of correction, must also reduce participants' exclusion allowances by being treated as amounts previously excludable under § 403(b)(2)(A)(ii) beginning with the year following the year of correction (or the year of correction if the employer so chooses). This correction must generally be used for all participants who have Excess Amounts.

### **5. PRINCIPLES REGARDING CORRECTIVE ALLOCATIONS AND CORRECTIVE DISTRIBUTIONS.**

The following principles apply where an appropriate correction method includes the use of corrective allocations or corrective distributions. Corrective allocations are generally not made with respect to a 403(b) Plan.

- (a) Corrective allocations under a defined contribution plan should be based upon the terms of the plan and other applicable information at the time of the Qualification Failure (including the compensation that would have been used under the plan for the period with respect to which a corrective allocation is being made) and should be adjusted for earnings and forfeitures that would have been allocated to the participant's account if the failure had not occurred. The corrective allocation need not be adjusted for losses. For administrative convenience, in the case of corrective allocations, if the plan permitted directed investments for the years at issue, and thus had more than one fund, the plan would be permitted to use the highest rate earned in the plan for the period of the failure as the rate used for all corrective allocations, provided that most of the employees receiving the corrective allocations are nonhighly compensated employees.
- (b) A corrective allocation to a participant's account because of a failure to make a required allocation in a prior limitation year will not be considered an annual

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addition with respect to the participant for the limitation year in which the correction is made, but will be considered an annual addition for the limitation year to which the corrective allocation relates. However, the normal rules of § 404, regarding deductions, apply.

- (c) Corrective allocations should come only from employer contributions (including forfeitures if the plan permits their use to reduce employer contributions).
- (d) In the case of a defined benefit plan, a corrective distribution for an individual should be increased to take into account the delayed payment, consistent with the plan's actuarial adjustments.

### **6. SPECIAL EXCEPTIONS TO FULL CORRECTION.**

In general, a Qualification or 403(b) Failure must be fully corrected. Although the mere fact that correction is inconvenient or burdensome is not enough to relieve a Plan Sponsor of the need to make full correction, full correction may not be required in certain situations because it is unreasonable or not feasible. Even in these situations, the correction method adopted must be one that does not have significant adverse effects on participants and beneficiaries or the plan, and that does not discriminate significantly in favor of highly compensated employees. The exceptions described below specify those situations in which full correction is not required.

- (a) Reasonable estimates. If it is not possible to make a precise calculation, or the probable difference between the approximate and the precise restoration of a participant's benefits is insignificant and the administrative cost of determining precise restoration would significantly exceed the probable difference, reasonable estimates may be used in calculating appropriate correction.
- (b) Delivery of very small benefits. If the total corrective distribution due a participant or beneficiary is \$ 20 or less, the Plan Sponsor is not required to make the corrective distribution if the reasonable direct costs of processing and delivering the distribution to the participant or beneficiary would exceed the amount of the distribution.
- (c) Locating lost participants. Reasonable actions must be taken to find all current and former participants and beneficiaries to whom additional benefits are due, but who have not been located after a mailing to the last known address. In general, such actions include use of the Internal Revenue Service

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Letter Forwarding Program (see Rev. Proc. 94-22, 1994-1 C.B. 608) or the Social Security Administration Reporting Service. A plan will not be considered to have failed to correct a failure due to the inability to locate an individual if either of these programs is used; provided that, if the individual is later located, the additional benefits must be provided to the individual at that time.

### **7. CORRECTION OF A PLAN OF AN INELIGIBLE EMPLOYER.**

The permitted correction of a Plan of an Ineligible Employer under TVC is the cessation of all contributions (including salary reduction and after-tax contributions) beginning no later than the date the application under TVC is filed. Pursuant to TVC correction, the assets in such a plan are to remain in the annuity contract or custodial account and are to be distributed no earlier than the occurrence of one of the distribution events described in § 403(b)(7) (to the extent the assets are held in custodial accounts) or § 403(b)(11) (for those assets invested in annuity contracts that would be subject to § 403(b)(11) restrictions if the employer were eligible). A Plan of an Ineligible Employer that is corrected through TVC will be treated as subject to all of the requirements and provisions of § 403(b), including the provisions of § 403(b)(8) (relating to rollovers). Because a Plan of an Ineligible Employer will be treated as subject to all of the requirements of 403(b), the plan must, as part of TVC correction, also correct all other Operational, Demographic, and Eligibility Failures in accordance with this revenue procedure. The correction of a Plan of an Ineligible Employer is subject to the fee described in section 13.06(4) below (or, with respect to the correction of multiple failures, section 13.06(5)).

### **8. REPORTING.**

Any distributions from the plan should be properly reported.

### **.03 CORRECTION UNDER STATUTE OR REGULATIONS.**

Generally, none of the correction programs are available to correct failures that can be corrected under the Code and related regulations. For example, as a general rule, a Plan Document Failure that is a disqualifying provision for which the remedial amendment period under § 401(b) has not expired can be corrected by operation of the Code through retroactive remedial amendment.

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### **.04 MATTERS SUBJECT TO EXCISE TAXES.**

- (1) Except as provided in paragraph (3) below, excise taxes and additional taxes, to the extent applicable, are not waived merely because the underlying failure has been corrected or because the taxes result from the correction. Thus, for example, the excise tax on certain excess contributions under § 4979 is not waived under these correction programs.
- (2) Except as provided in paragraph (3) below, for Qualified Plans, the correction programs are not available for events for which the Code provides tax consequences other than plan disqualification (such as the imposition of an excise tax or additional income tax). For example, funding deficiencies (failures to make the required contributions to a plan subject to § 412), prohibited transactions, and failures to file the Form 5500 cannot be corrected under the correction programs. However, if the event is also an Operational Failure (for example, if the terms of the plan document relating to plan loans to participants were not followed and loans made under the plan did not satisfy § 72(p)(2)), the correction programs will be available to correct the Operational Failure, even though the excise or income taxes generally still will apply.
- (3) For Qualified Plans and 403(b) Plans, as part of the VCR, Walk-in CAP, or TVC programs, if the failure involves the failure to satisfy the minimum required distribution requirements of § 401(a)(9), in appropriate cases, the Service will waive the excise tax under § 4974 applicable to plan participants.

### **.05 CONFIDENTIALITY AND DISCLOSURE.**

Because each correction program relates directly to the enforcement of the qualification or 403(b) requirements, the information received or generated by the Service under the program is subject to the confidentiality requirements of § 6103, and is not a written determination within the meaning of § 6110.

### **.06 NO EFFECT ON OTHER LAW.**

Correction under these programs has no effect on the rights of any party under any other law, including Title I of the Employee Retirement Income Security Act of 1974.

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### **PART IV. SELF-CORRECTION (APRSC)**

#### **SECTION 7. IN GENERAL**

The requirements of this section are satisfied with respect to an Operational Failure if the Plan Sponsor satisfies the requirements of section 8 (relating to insignificant Operational Failures), or section 9 (relating to significant Operational Failures).

#### **SECTION 8. SELF-CORRECTION OF INSIGNIFICANT OPERATIONAL FAILURES**

##### **.01 REQUIREMENTS.**

The requirements of this section are satisfied with respect to an Operational Failure if the Operational Failure is corrected and, given all the facts and circumstances, the Operational Failure is insignificant. This section is available for correcting an insignificant Operational Failure even if the plan or Plan Sponsor is Under Examination.

##### **.02 FACTORS.**

The factors to be considered in determining whether or not an Operational Failure under a plan is insignificant include, but are not limited to: (1) whether other failures occurred during the period being examined (for this purpose, a failure is not considered to have occurred more than once merely because more than one participant is affected by the failure); (2) the percentage of plan assets and contributions involved in the failure; (3) the number of years the failure occurred; (4) the number of participants affected relative to the total number of participants in the plan; (5) the number of participants affected as a result of the failure relative to the number of participants who could have been affected by the failure; (6) whether correction was made within a reasonable time after discovery of the failure; and (7) the reason for the failure (for example, data errors such as errors in the transcription of data, the transposition of numbers, or minor

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arithmetic errors). No single factor is determinative. Additionally, factors (4) and (5) should not be interpreted to exclude small businesses.

### **.03 MULTIPLE FAILURES.**

In the case of a plan with more than one Operational Failure in a single year, or Operational Failures that occur in more than one year, the Operational Failures are eligible for correction under this section only if all of the Operational Failures are insignificant in the aggregate. Operational Failures that have been corrected under APRSC in section 9, the VCR program in section 10, Walk-in CAP in section 11 or TVC in section 11 are not taken into account for purposes of determining if Operational Failures are insignificant in the aggregate.

### **.04 EXAMPLES.**

The following examples illustrate the application of this section. It is assumed, in each example, that the eligibility requirements of section 4 relating to APRSC have been satisfied and that no Operational Failures occurred other than the Operational Failures identified below.

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#### Example 1:

In 1984, Employer X established Plan A, a profit-sharing plan that satisfies the requirements of § 401(a) in form. In 1999, the benefits of 50 of the 250 participants in Plan A were limited by § 415(c). However, when the Service examined Plan A in 2002, it discovered that, during the 1999 limitation year, the annual additions allocated to the accounts of 3 of these employees exceeded the maximum limitations under § 415(c). Employer X contributed \$ 3,500,000 to the plan for the plan year. The amount of the excesses totaled \$ 4,550. Under these facts, because the number of participants affected by the failure relative to the total number of participants who could have been affected by the failure, and the monetary amount of the failure relative to the total employer contribution to the plan for the 1999 plan year, are insignificant, the § 415(c) failure in Plan A that occurred in 1999 would be eligible for correction under this section.

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#### Example 2:

The facts are the same as in Example 1, except that the failure to satisfy § 415 occurred during each of the 1998, 1999, and 2000 limitation years. In addition, the three



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participants affected by the § 415 failure were not identical each year. The fact that the § 415 failures occurred during more than one limitation year did not cause the failures to be significant; accordingly, the failures are still eligible for correction under this section.

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### Example 3:

The facts are the same as in Example 1, except that the annual additions of 18 of the 50 employees whose benefits were limited by § 415(c) nevertheless exceeded the maximum limitations under § 415(c) during the 1999 limitation year, and the amount of the excesses ranged from \$ 1,000 to \$ 9,000, and totaled \$ 150,000. Under these facts, taking into account the number of participants affected by the failure relative to the total number of participants who could have been affected by the failure for the 1999 limitation year (and the monetary amount of the failure relative to the total employer contribution), the failure is significant. Accordingly, the § 415(c) failure in Plan A that occurred in 1999 is ineligible for correction under this section as an insignificant failure.

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Example 4: Employer J maintains Plan C, a money purchase pension plan established in 1992. The plan document satisfies the requirements of § 401(a) of the Code. The formula under the plan provides for an employer contribution equal to 10% of compensation, as defined in the plan. During its examination of the plan for the 1999 plan year, the Service discovered that the employee responsible for entering data into the employer's computer made minor arithmetic errors in transcribing the compensation data with respect to 6 of the plan's 40 participants, resulting in excess allocations to those 6 participants' accounts. Under these facts, the number of participants affected by the failure relative to the number of participants that could have been affected is insignificant, and the failure is due to minor data errors. Thus, the failure occurring in 1999 would be insignificant and therefore eligible for correction under this section.

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### Example 5:

Public School maintains for its 200 employees a salary reduction 403(b) plan (the "Plan") which satisfies the requirements of § 403(b). The business manager has primary responsibility for administering the Plan, in addition to other administrative functions within Public School. During the 1998 plan year, a former employee should have received an additional minimum required distribution of \$ 278 under § 403(b)(10). Another participant received an impermissible hardship withdrawal of \$ 2,500. Another participant made elective deferrals of \$ 11,000, \$ 1,000 of which was in excess of the § 402(g) limit. Under these facts, even though multiple failures occurred in a single plan year, the failures will be eligible for correction under this section because in the aggregate the failures are insignificant.

## **SECTION 9. SELF-CORRECTION OF SIGNIFICANT OPERATIONAL FAILURES**

### **.01 REQUIREMENTS.**

The requirements of this section are satisfied with respect to an Operational Failure (even if significant) if the Operational Failure is corrected and the correction is either completed or substantially completed (in accordance with section 9.03) by the last day of the correction period described in section 9.02.

### **.02 CORRECTION PERIOD.**

The last day of the correction period for an Operational Failure is the last day of the second plan year following the plan year for which the failure occurred. However, in the case of a failure to satisfy the requirements of § 401(k)(3), 401(m)(2), or 401(m)(9), the plan year that includes the last day of the additional period for correction permitted under § 401(k)(8) or 401(m)(6) is treated, for this purpose, as the plan year for which the Operational Failure occurs. The correction period for an Operational Failure that occurs for any plan year ends, in any event, on the first date the plan or Plan Sponsor is Under Examination for that plan year (determined without regard to the exception in the preceding sentence). (But see section 9.03 for special rules permitting completion of correction after the end of the correction period.) If a 403(b) Plan does not have a plan year, the calendar year is considered to be the plan year for purposes of this section.

### **.03 SUBSTANTIAL COMPLETION OF CORRECTION.**

Correction of an Operational Failure is substantially completed by the last day of the correction period only if the requirements of either paragraph (1) or (2) are satisfied.

(1) The requirements of this paragraph (1) are satisfied if:

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- (a) during the correction period, the Plan Sponsor is reasonably prompt in identifying the Operational Failure, formulating a correction method, and initiating correction in a manner that demonstrates a commitment to completing correction of the Operational Failure as expeditiously as practicable, and
  - (b) within 90 days after the last day of the correction period, the Plan Sponsor completes correction of the Operational Failure.
- (2) The requirements of this paragraph (2) are satisfied if:
  - (a) during the correction period, correction is completed with respect to 85% of all participants affected by the Operational Failure, and
  - (b) thereafter, the Plan Sponsor completes correction of the Operational Failure with respect to the remaining affected participants in a diligent manner.

### **.04 EXAMPLE.**

The following example illustrates the application of this section. Assume that the eligibility requirements of section 4 relating to APRSC have been met.

Employer Z established a qualified defined contribution plan in 1986 and received a favorable determination letter for TRA '86. During 1999, while doing a self-audit of the operation of the plan for the 1998 plan year, the plan administrator discovered that, despite the practices and procedures established by Employer Z with respect to the plan, several employees eligible to participate in the plan were excluded from participation. The administrator also found that for 1998 the elective deferrals of additional employees exceeded the § 402(g) limit and discovered Operational Failures in 1998 with respect to the top-heavy provisions of the plan. During the 1999 plan year, the Plan Sponsor made corrective contributions on behalf of the excluded employees, distributed the excess deferrals to the affected participants, and made a top-heavy minimum contribution to all participants entitled to that contribution for the 1999 plan year. Each corrective contribution and distribution was credited with earnings at a rate appropriate for the plan from the date the corrective contribution or distribution should have been made to the date of correction. Under these facts, the Plan Sponsor has corrected the Operational Failures for the 1998 plan year within the correction period and thus satisfied the requirements of this section.

**PART V. VOLUNTARY CORRECTION WITH SERVICE APPROVAL (VCR, WALK-IN CAP AND TVC)**

**SECTION 10. VCR PROGRAM**

**.01 VCR REQUIREMENTS.**

The requirements of this section are satisfied with respect to an Operational Failure if the submission requirements of section 12 below are satisfied and the Plan Sponsor corrects the failures identified in accordance with the compliance statement described in section 10.13.

**.02 IDENTIFICATION OF FAILURES.**

The VCR program is not based upon an examination of the plan by the Service. The Service will not make any investigation or finding under the VCR program concerning whether there are Operational Failures. Only the Operational Failures raised by the Plan Sponsor or Operational Failures identified by the Service in processing the application will be addressed under the program, and only those failures will be covered by the program. However, because the VCR program does not arise out of an examination, consideration under the VCR program does not preclude or impede (under § 7605(b) or any administrative provisions adopted by the Service) a subsequent examination of the Plan Sponsor or the plan by the Service with respect to the taxable year (or years) involved with respect to matters that are outside the compliance statement. A Plan Sponsor's statements describing Operational Failures are made only for purposes of the VCR program and will not be regarded by the Service as an admission of a failure for purposes of any subsequent examination. If the plan failures include failures correctable under VCR and failures correctable under Walk-in CAP, (e.g., interrelated Operational and Document Failures), the Plan Sponsor may include all such failures in a submission under Walk-in CAP.

**.03 NO CONCURRENT EXAMINATION ACTIVITY.**

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Except in unusual circumstances, a plan that has been properly submitted under the VCR program will not be examined while the submission is pending. This practice regarding concurrent examinations does not extend to other plans of the Plan Sponsor. Thus, any plan of the Plan Sponsor that is not pending under the VCR program could be subject to examination.

### **.04 INSUFFICIENT INFORMATION.**

Where it is not possible to obtain sufficient information to properly determine the nature or extent of a failure or there is insufficient information to effect proper correction, or in other special circumstances where the application of the VCR program would be inappropriate or impractical, the failure cannot be corrected under the VCR program.

### **.05 INITIAL PROCESSING.**

- (1) The Service will review whether the eligibility requirements of section 4 and the submission requirements of section 12 are satisfied.
- (2) If the plan is not the subject of a Favorable Letter or the failure is not an Operational Failure, the compliance fee will be returned to the Plan Sponsor, and the Plan Sponsor will be informed of the option to voluntarily request consideration under Walk-in CAP.
- (3) If a Plan Sponsor requests a compliance statement under the VCR program for a plan with egregious failures described in section 4.07, the compliance fee will be returned and the Plan Sponsor will be given 60 days to voluntarily request consideration under Walk-in CAP. If by the end of the 60-day period, a request for consideration under Walk-in CAP has not been received, the VCR request will be forwarded to Employee Plans Examinations (see section 12.12 of this revenue procedure) for examination consideration.
- (4) If the Service determines that a submission is seriously deficient, the Service reserves the right to return the submission and the compliance fee without contacting the Plan Sponsor.
- (5) If a request for consideration under the VCR program is not described in paragraph (2), (3), or (4) above, but nevertheless fails to comply with the provisions of this revenue procedure or if additional information is required, a

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Service representative will generally contact the Plan Sponsor or the Plan Sponsor's representative and explain what is needed to complete the submission. The Plan Sponsor will have 21 calendar days from the date of this contact to provide the requested information. If the information is not received within 21 days, the matter will be closed, the compliance fee will not be returned, and the case may be referred to Employee Plans Examinations in accordance with section 10.05(3). Any request for an extension of the 21-day time period must be made in writing within the 21-day time period and must be approved by the Service.

### **.06 PROCESSING OF ACCEPTABLE SUBMISSION.**

Once the Service determines that a request for consideration under the VCR program is acceptable, the Service will consult with the Plan Sponsor or the Plan Sponsor's representative to discuss the proposed corrections and the plan's administrative procedures. If agreement is reached, the Service will issue a compliance statement with an enclosed acknowledgment letter for signature by the Plan Sponsor. The case will not be closed favorably until the Service has received the signed acknowledgement letter from the Plan Sponsor. The Service will discuss the appropriateness of the plan's existing administrative procedures with the Plan Sponsor. Where current procedures are inadequate for operating the plan in conformance with the qualification requirements of the Code, the compliance statement will be conditioned upon the implementation of stated procedures within the stated time period. The Service may prescribe appropriate administrative procedures in the compliance statement.

### **.07 FAILURES DISCOVERED AFTER INITIAL SUBMISSION.**

- (1) A Plan Sponsor that discovers additional, unrelated Operational Failures after its initial submission may request that such failures be added to its submission. The Service retains the discretion to reject the inclusion of such failures if the request is not timely, for example, if the Plan Sponsor makes its request when processing of the VCR submission is substantially complete.
- (2) If the Service discovers an unrelated Operational Failure while the request is pending under the VCR program, the failure generally will be added to the failures under consideration in the submission. The Service retains the discretion to determine that a failure is outside the scope of the voluntary request for consideration because it was not voluntarily brought forward by the Plan

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Sponsor. In this case, the plan may be forwarded to Employee Plans Examinations for consideration on examination, but forwarding to Employee Plans Examinations will occur only in rare or unusual circumstances.

### **.08 CONFERENCE RIGHT.**

If the Service initially determines that it cannot issue a compliance statement because the parties cannot agree upon correction or a change in administrative procedures, the Plan Sponsor or the Plan Sponsor's representative will be contacted by the Service representative and offered a conference with the Service. The conference can be held either in person or by telephone, and must be held within 21 calendar days of the date of contact. The Plan Sponsor will have 21 calendar days after the date of the conference to submit additional information in support of the submission. Any request for an extension of the 21-day time period must be made in writing within the 21-day time period and must be approved by the Service. Additional conferences may be held at the discretion of the Service.

### **.09 FAILURE TO REACH RESOLUTION.**

If resolution cannot be reached (for example, where information is not timely provided to the Service or because agreement cannot be reached on correction or a change in administrative procedures), the compliance fee will not be returned, and the case may be referred to Employee Plans Examinations for examination consideration.

### **.10 CONCURRENT PROCESSING OF DETERMINATION LETTER APPLICATIONS.**

The Service may process a determination letter application (including an application requested on Form 5310, Application for Determination of Qualification Upon Termination) concurrently with a VCR submission for the same plan. However, issuance of the determination letter in response to an application made on a Form 5310 will be suspended pending the closure of the VCR submission.

### **.11 SPECIAL RULES RELATING TO SVP.**

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- (1) Under the VCR program, certain Operational Failures may be corrected under the Standardized VCR Procedure ("SVP") rules in this section. SVP is available if the plan's only identified Operational Failure or Failures are listed in Appendix A or Appendix B of this revenue procedure and the failures are corrected in accordance with an applicable correction method set forth in Appendix A or Appendix B. Appropriate correction must be made for any Qualification Failure that results from the application of an SVP correction. The Plan Sponsor must request an SVP compliance statement and pay the reduced compliance fee set forth in section 13.04.
- (2) The correction methods set forth in Appendix A and Appendix B are strictly construed and are the only acceptable correction methods for failures corrected under SVP. If the Plan Sponsor wishes to modify a correction method provided in Appendix A or Appendix B or to propose another method, the Plan Sponsor may not use SVP, but may request a compliance statement under the regular VCR procedures.
- (3) SVP is not available if the Plan Sponsor has identified more than two SVP failures in a single SVP request. If there are one or two failures that can be corrected under SVP and other failures that cannot be corrected under SVP, SVP is not available. The Service reserves the right to shift requests for consideration under SVP into the regular VCR program if the Plan Sponsor submits a second SVP request with respect to the same plan while the first SVP request is being considered or during the 12 months after the first SVP compliance statement is issued. Both SVP requests may be shifted into the regular VCR program if the first SVP request is still being considered.
- (4) The Service will review an SVP request within 120 days of the date the submission is received and determined to be complete. If the Service determines that the request is acceptable, the Service will issue a compliance statement on the Plan Sponsor's proposed correction.

### **.12 GENERAL DESCRIPTION OF COMPLIANCE STATEMENT.**

Under the VCR program, a Plan Sponsor receives a compliance statement from the Service. The compliance statement addresses the failures identified, the terms of correction, and any revision of administrative procedures, and provides that the Service will not treat the plan as disqualified on account of the Operational Failures described in the compliance statement. In addition, the time period within which proposed corrections and changes in administrative



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procedures must be implemented are set forth in the compliance statement. The compliance statement is conditioned on the accuracy and acceptability of any calculations or other material submitted in connection with the request.

### **.13 COMPLIANCE STATEMENT CONDITIONED UPON TIMELY CORRECTION.**

The compliance statement is conditioned upon the implementation of the specific corrections and administrative changes set forth in the compliance statement within 150 days of the date of the compliance statement. Any request for an extension of this time period must be made in advance and in writing and must be approved by the Service.

### **.14 COMPLIANCE STATEMENT FOR NEW PLANS CONDITIONED UPON TIMELY AMENDMENT.**

Reliance on any compliance statement issued for a plan initially adopted or effective after December 7, 1994, other than an adoption of a master or prototype or regional prototype plan, is conditioned upon the plan being timely submitted for a determination letter within the plan's remedial amendment period under § 401(b).

### **.15 ACKNOWLEDGEMENT LETTER.**

Within 30 calendar days after the compliance statement is issued, a Plan Sponsor that wishes to agree to the terms of the compliance statement must send a signed acknowledgement letter to the Service, agreeing to the terms of the compliance statement. If the Plan Sponsor does not send the Service a signed acknowledgement letter within 30 calendar days, the plan may be referred to Employee Plans Examinations for examination consideration. Once the compliance statement has been issued (based on the information provided), the Plan Sponsor cannot request a modification of the compliance terms except by a new request for a compliance statement. However, if the requested modification is minor and is postmarked no later than 30 days after the compliance statement is issued, the VCR compliance fee for the modification will be the lesser of the original compliance fee or \$ 1,250.

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### **.16 VERIFICATION.**

Once the compliance statement has been issued, the Service may require verification that the corrections have been made and that any plan administrative procedures required by the statement have been implemented. This verification does not constitute an examination of the books and records of the employer or the plan (within the meaning of § 7605(b)). If the Service determines that the Plan Sponsor did not implement the corrections and procedures within the stated time period, the Service may consider the issues in an examination.

## **SECTION 11. WALK-IN CAP AND TVC**

### **.01 WALK-IN CAP REQUIREMENTS.**

- (1) The requirements of this section are satisfied with respect to a Plan Document, Operational, or a Demographic Failure if the submission requirements of section 12 are satisfied, the Plan Sponsor pays the compliance correction fee, and the Plan Sponsor corrects the failures identified in accordance with a closing agreement entered into by the Service and the Plan Sponsor. Payment of the compliance correction fee is generally required at the time the closing agreement is signed.
- (2) A determination letter application does not satisfy the submission requirements under Walk-in CAP.
- (3) Depending on the nature of the failure, the Service will discuss the appropriateness of the plan's existing administrative procedures with the Plan Sponsor. Where current administrative procedures are inadequate for operating the plan in conformance with the qualification requirements of the Code, the closing agreement may be conditioned upon the implementation of stated administrative procedures.
- (4) In addition, the Plan Sponsor is required to obtain a Favorable Letter before the closing agreement is signed unless the Service determines that it is unnecessary based on the facts and circumstances (for example, because the plan already has a Favorable Letter and no significant amendments are adopted). If a Favorable Letter is required, the Plan Sponsor would be required to pay the applicable user fee for obtaining the letter.

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### **.02 FAILURES DISCOVERED AFTER INITIAL SUBMISSION.**

- (1) A Plan Sponsor that discovers additional, unrelated failures after its initial submission may request that such failures be added to its submission. However, the Service retains the discretion to reject the inclusion of such failures if the request is not timely, for example, if the Plan Sponsor makes its request when processing of the submission is substantially complete.
- (2) If the Service discovers an unrelated plan failure while the request is pending, the failure generally will be added to the failures under consideration. However, the Service retains the discretion to determine that a failure is outside the scope of the voluntary request for consideration because it was not voluntarily brought forward by the Plan Sponsor. In this case, if the additional failure is significant, all aspects of the plan will be examined, and the rules pertaining to Audit CAP will apply.

### **.03 FAILURE TO REACH RESOLUTION.**

If the Service and the Plan Sponsor cannot reach agreement with respect to the submission, all aspects of the plan may be examined, and the rules pertaining to Audit CAP will apply.

### **.04 EFFECT OF CLOSING AGREEMENT.**

The closing agreement is binding upon both the Service and the Plan Sponsor with respect to the specific tax matters identified therein for the periods specified, but does not preclude or impede an examination of the plan by the Service relating to matters outside the closing agreement, even with respect to the same taxable year or years to which the closing agreement relates.

### **.05 TVC.**

The provisions in section 11.01 through .04 above apply to TVC except that TVC applies to Operational, Demographic, and Eligibility Failures with respect to a 403(b) Plan. In addition, there is no requirement that the employer obtain a private letter ruling from the Service covering its 403(b) Plan.

**SECTION 12. APPLICATION PROCEDURES FOR VCR, WALK-IN CAP AND TVC**

**.01 GENERAL RULES.**

This section sets forth the procedures for requesting a compliance statement from the Service under the VCR program (including SVP) and for requesting a closing agreement under Walk-in CAP and TVC. In general, a request under the VCR program, Walk-in CAP or TVC consists of a letter from the Plan Sponsor or the Plan Sponsor's representative to the Service that contains a description of the failures, a description of the proposed methods of correction, and other procedural items, and includes supporting information and documentation as described below.

**.02 MULTIEMPLOYER AND MULTIPLE EMPLOYER PLANS.**

In the case of a multiemployer or multiple employer plan, the plan administrator (rather than any contributing or adopting employer) must request consideration of the plan under the programs. The request must be with respect to the plan, rather than a portion of the plan affecting any particular employer.

**.03 SUBMISSION REQUIREMENTS.**

The letter from the Plan Sponsor or the Plan Sponsor's representative must contain the following:

- (1) A complete description of the failures and the years in which the failures occurred, including closed years (that is, years for which the statutory period has expired).
- (2) A description of the administrative procedures in effect at the time the failures occurred.
- (3) An explanation of how and why the failures arose.
- (4) A detailed description of the method for correcting the failures that the Plan Sponsor has implemented or proposes to implement. Each step of the correction

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method must be described in narrative form. The description must include the specific information needed to support the suggested correction method. This information includes, for example, the number of employees affected and the expected cost of correction (both of which may be approximated if the exact number cannot be determined at the time of the request), the years involved, and calculations or assumptions the Plan Sponsor used to determine the amounts needed for correction. See section 10.11 for special procedures regarding SVP.

- (5) A description of the methodology that will be used to calculate earnings or actuarial adjustments on any corrective contributions or distributions (indicating the computation periods and the basis for determining earnings or actuarial adjustments, in accordance with section 6.02(5)).
- (6) Specific calculations for each affected employee or a representative sample of affected employees. The sample calculations must be sufficient to demonstrate each aspect of the correction method proposed. For example, if a Plan Sponsor requests a compliance statement with respect to a failure to satisfy the contribution limits of § 415(c) and proposes a correction method that involves elective contributions (both matched and unmatched) and matching contributions, the Plan Sponsor must submit calculations illustrating the correction method proposed with respect to each type of contribution. As another example, with respect to a failure to satisfy the actual deferral percentage ("ADP") test in § 401(k)(3), the Plan Sponsor must submit the ADP test results both before the correction and after the correction.
- (7) The method that will be used to locate and notify former employees and beneficiaries, or an affirmative statement that no former employees or beneficiaries were affected by the failures.
- (8) A description of the measures that have been or will be implemented to ensure that the same failures will not recur.
- (9) A statement that, to the best of the Plan Sponsor's knowledge, neither the plan nor the Plan Sponsor is Under Examination.
- (10) In the case of a VCR submission, a statement (if applicable) that the plan is currently being considered in a determination letter application. If the request for a determination letter is made while a request for consideration under VCR is pending, the Plan Sponsor must update the VCR request to add this information.

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- (11) In the case of an SVP submission, a statement that it is an SVP request, a description of the applicable correction in accordance with Appendix A or Appendix B, and a statement that the Plan Sponsor proposes to implement (or has implemented) the correction(s).
- (12) In the case of a TVC submission, an application under TVC must contain a statement that the employer has contacted all other entities involved with the plan and has been assured of cooperation in implementing the applicable correction, to the extent necessary. For example, if the plan's failure is the failure to satisfy the requirements of § 403(b)(1)(E) on elective deferrals, the employer must, prior to making the TVC application, contact the insurance company or custodian with control over the plan's assets to assure cooperation in effecting a distribution of the excess deferrals and the earnings thereon.

### **.04 REQUIRED DOCUMENTS.**

The submission must be accompanied by the following documents:

- (1) In the case of a VCR submission, a copy of the first page and a copy of the page containing employee census information (currently, line 7f of the 1998 Form 5500) and a copy of the page containing the total amount of plan assets (currently, line 31f of the 1998 Form 5500) of the most recently filed Form 5500 series return, or in the case of a Walk-in CAP submission, a copy of the most recently filed Form 5500 series return.
- (2) Under TVC, the first two pages of the most recently filed Form 5500, or if inapplicable, the information generally included on the first two pages, including the name and number of the plan, and the employer's Employer Identification Number.
- (3) A copy of the relevant portions of the plan document. For example, in a case involving improper exclusion of eligible employees from a profit-sharing plan with a cash or deferred arrangement, relevant portions of the plan document include the eligibility, allocation, and cash or deferred arrangement provisions of the basic plan document (and the adoption agreement, if applicable), along with applicable definitions in the plan. If the plan is a 403(b) Plan and a plan document is not available, written descriptions of the plan, and sample salary reduction agreements if relevant.

## **EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001**

- (4) In the case of a VCR submission, a copy of the determination letter, opinion letter, or notification letter that considered TRA '86, except:
- (a) a governmental plan, or a non-electing church plan described in Rev. Proc. 99-23 for which the TRA '86 remedial amendment period has not yet expired should submit a copy of the determination, opinion, or notification letter that considered TEFRA, DEFRA, and REA and a statement that explains the reason why the period has not yet expired, and
  - (b) plans initially adopted or effective after December 7, 1994, should submit a statement that the plan will be submitted timely for a determination, opinion, or notification letter within the plan's remedial amendment period under § 401(b).
- (5) In the case of a TVC submission, a statement as to the type of employer (e.g., a tax-exempt organization described in § 501(c)(3)) submitting the TVC application.

### **.05 FEE.**

The VCR submission must include the appropriate fee described in section 13.02 or 13.04 below. The Walk-in CAP or TVC compliance correction fee described in section 13.05 or 13.06 below is due at the time the closing agreement is signed.

### **.06 SIGNED SUBMISSION.**

The submission must be signed by the Plan Sponsor or the sponsor's representative.

### **.07 POWER OF ATTORNEY REQUIREMENTS.**

To sign the submission or to appear before the Service in connection with the submission, the Plan Sponsor's representative must comply with the requirements of section 9.02(11) and (12) of Rev. Proc. 2000-4, 2000-1 I.R.B. 115.

## **EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001**

### **.08 PENALTY OF PERJURY STATEMENT.**

The following declaration must accompany a request and any factual information or change in the submission at a later time: "Under penalties of perjury, I declare that I have examined this submission, including accompanying documents, and, to the best of my knowledge and belief, the facts presented in support of this submission are true, correct, and complete." The declaration must be signed by the Plan Sponsor, not the Plan Sponsor's representative.

### **.09 CHECKLIST.**

The Service will be able to respond more quickly to a VCR, Walk-in CAP or TVC request if the request is carefully prepared and complete. The checklist in Appendix C is designed to assist Plan Sponsors and their representatives in preparing a submission that contains the information and documents required under this revenue procedure. The checklist in Appendix C must be completed, signed, and dated by the Plan Sponsor or the Plan Sponsor's representative, and should be placed on top of the submission. A photocopy of this checklist may be used.

### **.10 DESIGNATION.**

The letter to the Service should be designated "VCR PROGRAM," "SVP/VCR PROGRAM," "WALK-IN CAP PROGRAM," or "TVC PROGRAM" as appropriate, in the upper right hand corner of the letter.

### **.11 VCR/SVP MAILING ADDRESS.**

VCR/SVP submissions should be mailed to:

Internal Revenue Service  
Attention: T:EP:RA:VC  
P.O. Box 14073  
Ben Franklin Station  
Washington, D.C. 20044



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### **.12 WALK-IN CAP AND TVC MAILING ADDRESS.**

Walk-in CAP and TVC submissions should be mailed to the appropriate Closing Agreement Coordinator at the address provided below:

If the entity is in:	Walk-in CAP and TVC applications should be sent to:
Connecticut, Maine Massachusetts, Michigan New Hampshire, New Jersey, New York, Ohio, Pennsylvania, Rhode Island, Vermont	<b>Employee Plans Walk-in CAP Interr Revenue Service, 10 Metro Tech Ce 625 Fulton Street Brooklyn, NY 112 Phone (718) 488-2372, FAX (718) 488 2405</b>
Alabama, Delaware, District of Columbia, Florida, Georgia, Indiana, Kentucky, Louisiana, Maryland, Mississippi, North Carolina, South Carolina, Tennessee, Virginia, West Virginia, any U.S. possession or foreign country	<b>Employee Plans Walk-in CAP, Interr Revenue Service, Room 1550 P.O. B 13163 Baltimore, MD 21203 Phone (410) 962-3499 FAX (410) 962-0882</b>
Arkansas, Illinois, Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, Oklahoma, South Dakota, Texas, Wisconsin	<b>Employee Plans Walk-in CAP, Interr Revenue Service, 230 S. Dearborn I 4913 Chi, Chicago, IL 60604, Phone (312) 312-886-1277, Fax 312-886-2386</b>
Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington, Wyoming	<b>Employee Plans Walk-in CAP, Interr Revenue Service, 2 Cupania Circle, Monterey Park, CA 91755-7431, (323) 869-3905</b>

### **.13 MAINTENANCE OF COPIES OF SUBMISSIONS.**

Plan Sponsors and their representatives should maintain copies of all correspondence submitted to the Service with respect to their VCR, Walk-in CAP and TVC requests.

## **SECTION 13. FEES**

### **.01 REV. PROC. 2000-8 MODIFIED.**

## **EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001**

The VCR compliance fee is processed under the user fee program described in Rev. Proc. 2000-8, 2000-1 I.R.B. 229.

### **.02 VCR FEE.**

Unless SVP is applicable, the VCR compliance fee depends on the assets of the plan and the number of plan participants.

- (1) The fee for a plan with assets of less than \$ 500,000, and no more than 1,000 plan participants, is \$ 500.
- (2) The fee for a plan with assets of at least \$ 500,000, and no more than 1,000 plan participants, is \$ 1,250.
- (3) The fee for a plan with more than 1,000 plan participants but less than 10,000 plan participants is \$ 5,000.
- (4) The fee for a plan with 10,000 or more plan participants is \$ 10,000.

### **.03 ESTABLISHING NUMBER OF PLAN PARTICIPANTS.**

The compliance fee is calculated by the Plan Sponsor using the numbers from the most recently filed Form 5500 series to establish the fee. Thus, with respect to the 1999 Form 5500, the Plan Sponsor would use the number shown on line 7(f) (or the equivalent line on the Form 5500 C/R or EZ) to establish the number of plan participants and would use line 31(f) (or the equivalent line on the Form 5500 C/R or EZ) to establish the amount of plan assets.

### **.04 SVP FEE.**

The SVP compliance fee is \$ 350.

### **.05 WALK-IN CAP COMPLIANCE CORRECTION FEE.**

- (1) Compliance correction fee chart.

## EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

The compliance correction fee for a Walk-in CAP application is determined in accordance with the chart below. The chart contains a graduated range of fees based on the size of the plan (with the number of participants determined as provided in section 13.03). Each range includes a minimum amount, a maximum amount, and a presumptive amount. In each case, the minimum amount is the applicable VCR fee in section 13.02. It is expected that in most instances the compliance correction fee imposed will be at or near the presumptive amount in each range; however, the fee may be a higher or lower amount within the range, depending on the factors in paragraph (2) below.

### WALK-IN CAP COMPLIANCE CORRECTION FEES

# of participants	Fee range	Presumptive Amount
10 or fewer	VCR fee * to \$ 4,000	\$ 2,000
11 to 50	VCR fee * to \$ 8,000	\$ 4,000
51 to 100	VCR fee * to \$ 12,000	\$ 6,000
101 to 300	VCR fee * to \$ 16,000	\$ 8,000
301 to 1,000	VCR fee * to \$ 30,000	\$ 15,000
over 1,000	VCR fee * to \$ 70,000	\$ 35,000*

Items marked by asterisk refer to the VCR compliance fee that would apply under section 13.02 if the plan had been submitted under the VCR program.

- (2) Factors considered. Consideration of whether the compliance correction fee should be equal to, greater than, or less than the presumptive amount will depend on factors relating to the nature, extent, and severity of the failure. These factors include: (a) whether the failure is a failure to satisfy the requirements of § 401(a)(4), § 401(a)(26), or § 410(b), (b) whether the plan has both Operational and Plan Document Failures, (c) the period over which the violation occurred (for example, the time that has elapsed since the end of the applicable remedial amendment period under § 401(b) for a Plan Document Failure), and (d) whether the plan has a Favorable Letter.
- (3) Egregious failures. In cases involving failures that are egregious (as described in section 4.07), (a) the maximum compliance correction fee applicable to the plan under the chart in 13.05(1) is increased to 40 percent of the Maximum Payment Amount, and (b) no presumptive amount applies.

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### **.06 TVC FEE.**

- (1) TVC Compliance correction fee. The applicable TVC compliance correction fee depends on the type of failure and, generally, the number of employees of the employer.
- (2) Fee for Operational Failures. Subject to section 13.06(5) below, the compliance correction fees for Operational Failures are as follows:
  - (a) The fee for an employer with fewer than 25 employees is \$ 500.
  - (b) The fee for an employer with at least 25 and no more than 1,000 employees is \$ 1,250.
  - (c) The fee for an employer with more than 1,000 employees but less than 10,000 is \$ 5,000.
  - (d) The fee for an employer with 10,000 or more employees is \$ 10,000.
- (3) Fee for certain Excess Amounts. Subject to section 13.06(5) below, the compliance correction fee for Excess Amounts that are corrected pursuant to section 6.02(4)(b)(i) above is equal to the sum of (1) the applicable fee described in section 13.06(2) above and (2) two percent of the Excess Amounts, adjusted for earnings through the date of the TVC application, contributed or allocated in the calendar year of the TVC application and in the three calendar years prior thereto. For purposes of determining the fee described in this section 13.06(3), where there is a failure to satisfy both the § 403(b)(2) and § 415 limits with respect to a single employee for a year, the fee will take into account only the greater Excess Amount.
- (4) Fee for Demographic and Eligibility Failures.
  - (a) Subject to section 13.06(5) below, the compliance correction fee for a 403(b) Plan with failures that include Demographic or Eligibility Failures is determined in accordance with the table set forth above in section 13.05 with respect to Walk-In CAP, except that
    - (i) the reference to the "VCR fee" is changed to refer to the TVC compliance correction fee for Operational Failures set forth in section 13.06(2) above, and

## EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

- (ii) the fee is determined with reference to the number of employees rather than participants.

(b) Factors considered in determining the compliance correction fee for failures that include Demographic and Eligibility Failures under TVC include: (i) whether the failure is a Demographic Failure; (ii) whether the plan is a Plan of an Ineligible Employer; (iii) whether the 403(b) Plan has a combination of Operational, Demographic, and Eligibility failures; and (iv) the period of time over which the failure occurred.

(5) Fee for multiple failures.

If correction is requested for multiple failures, the compliance correction fee will be determined in accordance with the table set forth below.

Multiple Operational Failures	Fee described in section 13.06(2)
Multiple Demographic/Eligibility Failures	Fee described in section 13.06(4)
Combination of Operational and Demographic/Eligibility Failures	Fee described in section 13.06(4)
Operational Failure(s) with section 6.02(4)(b)(i) correction of Excess Amounts	Fee described in section 13.06(3)
Demographic/Eligibility Failures and Operational Failures including section 6.02(4)(b)(i) correction of Excess Amounts	Fee described in section 13.06(3), substituting section 13.06(4) fee for section 13.06(2)

(6) Fee for egregious failures. In cases involving failures that are egregious, the maximum compliance correction fee applicable to the plan is increased to 40 percent of the Total Sanction Amount and no presumptive amount applies.

## PART VI. CORRECTION ON AUDIT (AUDIT CAP)

### SECTION 14. DESCRIPTION OF AUDIT CAP

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### **.01 AUDIT CAP REQUIREMENTS.**

In the event the Service identifies a Qualification or 403(b) Failure (other than a failure that is not treated as resulting in disqualification of the plan under APRSC, VCR, Walk-in CAP, or TVC) upon an Employee Plans or Exempt Organizations examination of a Qualified Plan or a 403(b) Plan, the requirements of this section are satisfied with respect to the failure if the Plan Sponsor corrects the failure, pays a sanction in accordance with section 14.02, satisfies any additional requirements of section 14.03, and enters into a closing agreement with the Service.

### **.02 PAYMENT OF SANCTION.**

Under Audit CAP, the Plan Sponsor is subject to a sanction determined in accordance with section 15. Payment of the sanction generally will be required at the time the closing agreement is signed.

### **.03 ADDITIONAL REQUIREMENTS.**

Depending on the nature of the failure, the Service will discuss the appropriateness of the plan's existing administrative procedures with the Plan Sponsor. Where existing administrative procedures are inadequate for operating the plan in conformance with the qualification requirements of the Code, the closing agreement may be conditioned upon the implementation of stated procedures. In addition, for Qualified Plans, the Plan Sponsor may be required to obtain a Favorable Letter before the closing agreement is signed unless the Service determines that it is unnecessary based on the facts and circumstances (for example, because the plan already has a Favorable Letter and no significant amendments are adopted). If a Favorable Letter is required, the Plan Sponsor would be required to pay the applicable user fee for obtaining the letter.

### **.04 FAILURE TO REACH RESOLUTION.**

If the Service and the Plan Sponsor cannot reach an agreement with respect to the correction of the failure(s) or the amount of the sanction, the plan will be disqualified or, in the case of a 403(b) Plan, would not have reliance on this revenue procedure.

## **EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001**

### **.05 EFFECT OF CLOSING AGREEMENT.**

A closing agreement constitutes an agreement between the Service and the Plan Sponsor that is binding with respect to the tax matters identified therein for the periods specified.

### **.06 OTHER PROCEDURAL RULES.**

The procedural rules for Audit CAP are set forth in Internal Revenue Manual ("IRM") 7.9.2, EPCRS.

## **SECTION 15. AUDIT CAP SANCTION**

### **.01 DETERMINATION OF SANCTION.**

The sanction under Audit CAP is a negotiated percentage of the Maximum Payment Amount. For 403(b) Plans, the sanction is a negotiated percentage of the Total Sanction Amount. Sanctions will not be excessive and will bear a reasonable relationship to the nature, extent, and severity of the failures.

### **.02 FACTORS CONSIDERED.**

The amount of the sanction will depend on factors relating to the nature, extent, and severity of the failures, including the extent to which correction had progressed before the examination was initiated. For both Qualified Plans and 403(b) Plans, other factors relating to the nature, extent, and severity of the failures include:

- (1) the number and type of employees affected by the failure,
- (2) the number of nonhighly compensated employees who would be adversely affected if the plan was not treated as qualified or as satisfying the requirements of § 403(b),
- (3) whether the failure is a failure to satisfy the requirements of § 401(a)(4), § 401(a)(26), or § 410(b), either directly or through § 403(b)(12),

## **EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001**

- (4) the period over which the failure occurred (for example, the time that has elapsed since the end of the applicable remedial amendment period under § 410(b) for a Plan Document Failure), and
- (5) the reason for the failure (for example, data errors such as errors in transcription of data, the transposition of numbers, or minor arithmetic errors).

Factors relating to Qualified Plans also include:

- (1) whether the plan is the subject of a Favorable Letter, and
- (2) whether the plan has both Operational and Plan Document Failures.

Additional factors relating to 403(b) Plans include:

- (1) whether the plan has a combination of Operational, Demographic, or Eligibility Failures,
- (2) the extent to which the failure relates to Excess Amounts, and
- (3) whether the plan is a Plan of an Ineligible Employer.

## **PART VII. EFFECT ON OTHER DOCUMENTS, AND EFFECTIVE DATE**

### **SECTION 16. EFFECT ON OTHER DOCUMENTS**

#### **.01 REVENUE PROCEDURES MODIFIED AND SUPERSEDED.**

Rev. Procs. 98-22, 99-13, and 99-31 are modified and superseded by this revenue procedure. .02 Rev. Proc. 2000-8 modified. Rev. Proc. 2000-8 is modified as provided in section 12.

### **SECTION 17. EFFECTIVE DATE**



## **EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001**

This revenue procedure is generally effective May 1, 2000. In addition, employers are permitted, at their option, to apply the provisions of this revenue procedure on or after March 9, 1998 (the release date of Rev. Proc. 98-22). Unless an employer applies this revenue procedure earlier, this revenue procedure is effective:

- (1) with respect to VCR, Walk-in CAP and TVC, for applications submitted on or after May 1, 2000;
- (2) with respect to Audit CAP, for examinations begun on or after May 1, 2000; and
- (3) with respect to APRSC, for failures for which correction is not complete before May 1, 2000.

### **SECTION 18. PAPERWORK REDUCTION ACT**

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1673.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The collection of information in this revenue procedure is in sections 4.06, 6.02(4), 6.02(6)(c), 10.01, 10.02, 10.05-10.08, 10.11, 10.15, 11.01-11.03, 11.05, 12.01-12.04, 12.06-12.12, 14.01, section 2.01-2.07 of Appendix B, and Appendix C. This information is required to enable the Commissioner, Tax Exempt and Government Entities Division of the Internal Revenue Service to make determinations regarding the issuance of various types of closing agreements and compliance statements. This information will be used to issue closing agreements and compliance statements to allow individual plans to continue to maintain their tax qualified and tax-deferred status. As a result, favorable tax treatment of the benefits of the eligible employees is retained. The likely respondents are individuals, state or local governments, business or other for-profit institutions, nonprofit institutions, and small businesses or organizations.

The estimated total annual reporting and/or recordkeeping burden is 61,697 hours.

## **EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001**

The estimated annual burden per respondent/recordkeeper varies from .5 to 42.5 hours, depending on individual circumstances, with an estimated average of 14.54 hours. The estimated number of respondents and/or recordkeepers is 4,242.

The estimated frequency of responses is occasionally.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by 26 U.S.C. § 6103.

### **DRAFTING INFORMATION**

The principal authors of this revenue procedure are Maxine Terry and Carlton Watkins of the Tax Exempt and Government Entities Division. For further information concerning this revenue procedure, please contact Employee Plans' taxpayer assistance telephone service between 1:30 and 3:30 p.m., Eastern Time, Monday through Thursday at (202) 622-6074/6075. (These telephone numbers are not toll-free numbers.) Ms. Terry and Mr. Watkins may be reached at (202) 622-6214 (also not a toll-free number).

## **APPENDIX A-OPERATIONAL FAILURES AND CORRECTIONS UNDER SVP**

### **.01 GENERAL RULE.**

This appendix sets forth Operational Failures relating to Qualified Plans and corrections under SVP in accordance with section 10.11. In each case, the method described corrects the Operational Failure identified in the headings below. Corrective allocations and distributions should reflect earnings and actuarial adjustments in accordance with section 6.02(5)(a). The correction methods in this appendix are acceptable under APRSC. Additionally, the correction methods (other than correction by plan amendment under Walk-in CAP) and the earnings adjustment methods in Appendix B are acceptable under SVP.

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### **.02 FAILURE TO PROPERLY PROVIDE THE MINIMUM TOP-HEAVY BENEFIT UNDER § 416 OF THE CODE TO NON-KEY EMPLOYEES.**

In a defined contribution plan, the permitted correction method is to properly contribute and allocate the required top-heavy minimums to the plan in the manner provided for in the plan on behalf of the non-key employees (and any other employees required to receive top-heavy allocations under the plan). In a defined benefit plan, the minimum required benefit must be accrued in the manner provided in the plan.

### **.03 FAILURE TO SATISFY THE ADP TEST SET FORTH IN § 401(K)(3), THE ACP TEST SET FORTH IN § 401(M)(2), OR THE MULTIPLE USE TEST OF § 401(M)(9).**

The permitted correction method is to make qualified nonelective contributions (QNCs) (as defined in § 1.401(k)-1(g)(13)(ii)) on behalf of the nonhighly compensated employees to the extent necessary to raise the actual deferral percentage or actual contribution percentage of the nonhighly compensated employees to the percentage needed to pass the test or tests. The contributions must be made on behalf of all eligible nonhighly compensated employees (to the extent permitted under § 415) and must either be the same flat dollar amount or the same percentage of compensation. QNCs contributed to satisfy the ADP test need not be matched. Employees who would have been eligible for a matching contribution had they made elective contributions must be counted as eligible employees for the ACP test, and the plan must satisfy the ACP test. Under this SVP correction method, a plan may not be treated as two separate plans, one covering otherwise excludable employees and the other covering all other employees (as permitted in § 1.410(b)-6(b)(3)) in order to reduce the number of employees eligible to receive QNCs. Likewise, under this SVP correction method, the plan may not be restructured into component plans (as permitted in § 1.401(k)-1(h)(3)(iii) for plan years before January 1, 1992) in order to reduce the number of employees eligible to receive QNCs.

### **.04 FAILURE TO DISTRIBUTE ELECTIVE DEFERRALS IN EXCESS OF THE § 402(G) LIMIT (IN CONTRAVENTION OF § 401(A)(30)).**

The permitted correction method is to distribute the excess deferral to the employee and to report the amount as taxable in the year of deferral and in the year distributed. In accordance with § 1.402(g)-1(e)(1)(ii), a distribution to a

## **EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001**

highly compensated employee is included in the ADP test; a distribution to a nonhighly compensated employee is not included in the ADP test.

### **.05 EXCLUSION OF AN ELIGIBLE EMPLOYEE FROM ALL CONTRIBUTIONS OR ACCRUALS UNDER THE PLAN FOR ONE OR MORE PLAN YEARS.**

The permitted correction method is to make a contribution to the plan on behalf of the employees excluded from a defined contribution plan or to provide benefit accruals for the employees excluded from a defined benefit plan. If the employee should have been eligible to make an elective contribution under a cash or deferred arrangement, the employer must make a QNC to the plan on behalf of the employee that is equal to the actual deferral percentage for the employee's group (either highly compensated or nonhighly compensated). If the employee should have been eligible to make employee contributions or for matching contributions (on either elective contributions or employee contributions), the employer must make a QNC to the plan on behalf of the employee that is equal to the actual contribution percentage for the employee's group (either highly compensated or nonhighly compensated). Contributing the actual deferral or contribution percentage for such employees eliminates the need to rerun the ADP or ACP test to account for the previously excluded employees. Under this SVP correction method, a plan may not be treated as two separate plans, one covering otherwise excludable employees and the other covering all other employees (as permitted in § 1.410(b)-6(b)(3)) in order to reduce the amount of QNCs. Likewise, restructuring the plan into component plans under § 1.401(k)-1(h)(3)(iii) is not permitted in order to reduce the amount of QNCs.

### **.06 FAILURE TO TIMELY PAY THE MINIMUM DISTRIBUTION REQUIRED UNDER § 401(A)(9).**

In a defined contribution plan, the permitted correction method is to distribute the required minimum distributions. The amount to be distributed for each year in which the failure occurred should be determined by dividing the adjusted account balance on the applicable valuation date by the applicable divisor. For this purpose, adjusted account balance means the actual account balance, determined in accordance with § 1.401(a)(9)-1 Q&A F-5 of the proposed regulations, reduced by the amount of the total missed minimum distributions for prior years. In a defined benefit plan, the permitted correction method is to distribute the required minimum distributions, plus an interest payment representing the loss of use of such amounts.

**.07 FAILURE TO OBTAIN PARTICIPANT AND/OR SPOUSAL CONSENT FOR A DISTRIBUTION SUBJECT TO THE PARTICIPANT AND SPOUSAL CONSENT RULES UNDER §§ 401(A)(11), 411(A)(11) AND 417.**

The permitted correction method is to give each affected participant a choice between providing informed consent for the distribution actually made or receiving a qualified joint and survivor annuity. In order to use this SVP correction method, the Plan Sponsor must have contacted each affected participant and spouse (to whom the participant was married at the annuity starting date) and received responses from each such individual before requesting consideration under SVP. In the event that participant and/or spousal consent is required but cannot be obtained, the participant must receive a qualified joint and survivor annuity based on the monthly amount that would have been provided under the plan at his or her retirement date. This annuity may be actuarially reduced to take into account distributions already received by the participant. However, the portion of the qualified joint and survivor annuity payable to the spouse upon the death of the participant may not be actuarially reduced to take into account prior distributions to the participant.

Thus, for example, if in accordance with the automatic qualified joint and survivor annuity option under a plan, a married participant who retired would have received a qualified joint and survivor annuity of \$ 600 per month payable for life with \$ 300 per month payable to the spouse upon the participant's death but instead received a single-sum distribution equal to the actuarial present value of the participant's accrued benefit under the plan, then the \$ 600 monthly annuity payable during the participant's lifetime may be actuarially reduced to take the single-sum distribution into account. However, the spouse must be entitled to receive an annuity of \$ 300 per month payable for life beginning at the participant's death.

**.08 FAILURE TO SATISFY THE § 415 LIMITS IN A DEFINED CONTRIBUTION PLAN.**

The permitted correction for failure to limit annual additions (other than elective deferrals and employee contributions) allocated to participants in a defined contribution plan as required in § 415 (even if the excess did not result from the allocation of forfeitures or from a reasonable error in estimating compensation) is to place the excess annual additions into an unallocated account, similar to the suspense account described in § 1.415-6(b)(6)(iii), to be used as an employer

## **EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001**

contribution in the succeeding year(s). While such amounts remain in the unallocated account, the employer is not permitted to make additional contributions to the plan. The permitted SVP correction for failure to limit annual additions that are elective deferrals or employee contributions (even if the excess did not result from a reasonable error in determining the amount of elective deferrals or employee contributions that could be made with respect to an individual under the § 415 limits) is to distribute the elective deferrals or employee contributions using a method similar to that described under § 1.415-6(b)(6)(iv). Elective deferrals and employee contributions that are matched may be returned, provided that the matching contributions relating to such contributions are forfeited (which will also reduce excess annual additions for the affected individuals). The forfeited matching contributions are to be placed into an unallocated account to be used as an employer contribution in succeeding periods.

## **APPENDIX B-CORRECTION METHODS AND EXAMPLES, EARNINGS ADJUSTMENT METHODS AND EXAMPLES**

### **SECTION 1. PURPOSE, ASSUMPTIONS FOR EXAMPLES AND SECTION REFERENCES**

#### **.01 PURPOSE.**

- (1) This appendix sets forth correction methods relating to Operational Failures under Qualified Plans. This appendix also sets forth earnings adjustment methods. The correction methods and earnings adjustment methods described in this appendix are acceptable under SVP and APRSC.
- (2) This appendix does not apply to 403(b) Plans. Accordingly, sponsors of 403(b) Plans cannot rely on the correction methods and the earnings adjustment methods.

#### **.02 ASSUMPTIONS FOR EXAMPLES.**

Unless otherwise specified, for ease of presentation, the examples assume that:

## **EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001**

- (1) the plan year and the § 415 limitation year are the calendar year;
- (2) the employer maintains a single plan intended to satisfy § 401(a) and has never maintained any other plan;
- (3) in a defined contribution plan, the plan provides that forfeitures are used to reduce future employer contributions;
- (4) the Qualification Failures are Operational Failures and the eligibility and other requirements for APRSC, VCR, Walk-in CAP, or Audit CAP, whichever applies, are satisfied; and
- (5) there are no Qualification Failures other than the described Operational Failures, and if a corrective action would result in any additional Qualification Failure, appropriate corrective action is taken for that additional Qualification Failure in accordance with EPCRS.

.03 Section References. References to section 2 and section 3 are references to the section 2 and 3 of this appendix.

## **SECTION 2. CORRECTION METHODS AND EXAMPLES**

### **.01 ADP/ACP FAILURES.**

#### **1. CORRECTION METHODS.**

- (a) SVP Correction Method. Appendix A, section .03 sets forth the SVP correction method for a failure to satisfy the actual deferral percentage ("ADP"), actual contribution percentage ("ACP"), or multiple use test set forth in §§ 401(k)(3), 401(m)(2), and 401(m)(9), respectively.
- (b) One-to-One Correction Method.
  - (i) General. In addition to the SVP correction method, a failure to satisfy the ADP, ACP, or multiple use test may be corrected using the one-to-one correction method set forth in this section 2.01(1)(b). Under the one-to-one correction method, an excess contribution amount is determined and assigned to highly compensated employees as provided in paragraph (1)(b)(ii) below. That excess contribution amount (adjusted for earnings) is

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either distributed to the highly compensated employees or forfeited from the highly compensated employees' accounts as provided in paragraph (1)(b)(iii) below. That same dollar amount (i.e., the excess contribution amount, adjusted for earnings) is contributed to the plan and allocated to nonhighly compensated employees as provided in paragraph (1)(b)(iv) below.

- (ii) **Determination of the Excess Contribution Amount.** The excess contribution amount for the year is equal to the excess of (A) the sum of the excess contributions (as defined in § 401(k)(8)(B)), the excess aggregate contributions (as defined in § 401(m)(6)(B)), and the amount treated as excess contributions or excess aggregate contributions under the multiple use test pursuant to § 401(m)(9) and § 1.401(m)-2(c) of the Income Tax Regulations for the year, as assigned to each highly compensated employee in accordance with § 401(k)(8)(C) and (m)(6)(C), over (B) previous corrections that complied with § 401(k)(8), (m)(6), and (m)(9). See Notice 97-2, 1997-1 C.B. 348.
- (iii) **Distributions and Forfeitures of the Excess Contribution Amount.**
  - A. The portion of the excess contribution amount assigned to a particular highly compensated employee under paragraph (1)(b)(ii) is adjusted for earnings through the date of correction. The amount assigned to a particular highly compensated employee, as adjusted, is distributed or, to the extent the amount was forfeitable as of the close of the plan year of the failure, is forfeited. If the amount is forfeited, it is used in accordance with the plan provisions relating to forfeitures that were in effect for the year of the failure. If the amount so assigned to a particular highly compensated employee has been previously distributed, the amount is an Excess Amount within the meaning of section 5.01(3). Thus, pursuant to section 6.02(4)(a), the employer must notify the employee that the Excess Amount was not eligible for favorable tax treatment accorded to distributions from qualified plans (and, specifically, was not eligible for tax-free rollover).
  - B. If any matching contributions (adjusted for earnings) are forfeited in accordance with § 411(a)(3)(G), the forfeited amount is used in accordance with the plan provisions relating to forfeitures that were in effect for the year of the failure.



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C. If a payment was made to an employee and that payment is a forfeitable match described in either paragraph (1)(b)(iii)(A) or (B), then it is an Overpayment defined in section 2.05(2) that must be corrected (see section 2.05(1)).

(iv) Contribution and Allocation of Equivalent Amount.

(A) The employer makes a contribution to the plan that is equal to the aggregate amounts distributed and forfeited under paragraph (1)(b)(iii)(A) (i.e., the excess contribution amount adjusted for earnings, as provided in paragraph (1)(b)(iii)(A), which does not include any matching contributions forfeited in accordance with § 411(a)(3)(G) as provided in paragraph (1)(b)(iii)(B)). The contribution must satisfy the vesting requirements and distribution limitations of § 401(k)(2)(B) and (C).

(B)

(1) This paragraph (1)(b)(iv)(B)(1) applies to a plan that uses the current year testing method described in Notice 98-1, 1998-3 I.R.B. 42. The contribution made under paragraph (1)(b)(iv)(A) is allocated to the account balances of those individuals who were either

- (I) the eligible employees for the year of the failure who were not highly compensated employees for that year or
- (II) the eligible employees for the year of the failure who were not highly compensated employees for that year and who also are not highly compensated employees for the year of correction.

Alternatively, the contribution is allocated to account balances of eligible employees described in (I) or (II) of the preceding sentence, except that the allocation is made only to the account balances of those employees who are employees on a date during the year of the correction that is no later than the date of correction.

Regardless of which of these four options (described in the two preceding sentences) the employer selects, the contribution is allocated to each such employee either as the same percentage of the employee's compensation for the year of the failure or as the same dollar amount for each employee. (See Examples 1, 2 and 3.)

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Under the one-to-one correction method, the amount allocated to the account balance of an employee (i.e., the employee's share of the total amount contributed under paragraph (1)(b)(iv)(A)) is not further adjusted for earnings and is treated as an annual addition under § 415 for the year of the failure for the employee for whom it is allocated.

- (2) This paragraph (1)(b)(iv)(B)(2) applies to a plan that uses the prior year testing method described in Notice 98-1. Paragraph (1)(b)(iv)(B)(1) is applied by substituting "the year prior to the year of the failure" for "the year of the failure".

### **(2) EXAMPLES.**

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#### Example 1:

Employer A maintains a profit-sharing plan with a cash or deferred arrangement that is intended to satisfy § 401(k) ("401(k) plan") using the current year testing method described in Notice 98-1. The plan does not provide for matching contributions or employee after-tax contributions. In 1999, it was discovered that the ADP test for 1997 was not performed correctly. When the ADP test was performed correctly, the test was not satisfied for 1997. For 1997, the ADP for highly compensated employees was 9% and the ADP for nonhighly compensated employees was 4%. Accordingly, the ADP for highly compensated employees exceeded the ADP for nonhighly compensated employees by more than two percentage points (in violation of § 401(k)(3)). (The ADP for nonhighly compensated employees for 1996 also was 4%, so the ADP test for 1997 would not have been satisfied even if the plan had used the prior year testing method described in Notice 98-1.) There were two highly compensated employees eligible under the 401(k) plan during 1997, Employee P and Employee Q. Employee P made elective deferrals of \$ 8,000, which is equal to 10% of Employee P's compensation of \$ 80,000 for 1997. Employee Q made elective deferrals of \$ 9,500, which is equal to 8% of Employee Q's compensation of \$ 118,750 for 1997.

#### **Correction:**

On June 30, 1999, Employer A uses the one-to-one correction method to correct the failure to satisfy the ADP test for 1997. Accordingly, Employer A calculates the dollar amount of the excess contributions for the two highly compensated employees in the manner described in § 401(k)(8)(B). The amount of the excess contribution for Employee P is \$ 3,200 (4% of \$ 80,000) and the amount of the excess contribution for Employee Q is \$ 2,375 (2% of \$ 118,750), or a total of \$ 5,575. In accordance with §

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401(k)(8)(C), \$ 5,575, the excess contribution amount, is assigned \$ 2,037.50 to Employee P and \$ 3,537.50 to Employee Q. It is determined that the earnings on the assigned amounts through June 30, 1999 are \$ 407 and \$ 707 for Employees P and Q, respectively. The assigned amounts and the earnings are distributed to Employees P and Q. Therefore, Employee P receives \$ 2,444.50 (\$ 2,037.50 + \$ 407) and Employee Q receives \$ 4,244.50 (\$ 3,537.50 + \$ 707). In addition, on the same date, a corrective contribution is made to the 401(k) plan equal to \$ 6,689 (the sum of the \$ 2,444.50 distributed to Employee P and the \$ 4,244.50 distributed to Employee Q). The corrective contribution is allocated to the account balances of eligible nonhighly compensated employees for 1997, pro rata based on their compensation for 1997 (subject to § 415 for 1997).

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### Example 2:

The facts are the same as in Example 1.

### Correction:

The correction is the same as in Example 1, except that the corrective contribution of \$ 6,689 is allocated in an equal dollar amount to the account balances of eligible nonhighly compensated employees for 1997 who are employees on June 30, 1999 and who are nonhighly compensated employees for 1999 (subject to § 415 for 1997).

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### Example 3:

The facts are the same as in Example 1, except that for 1997 the plan also provides (1) for employee after-tax contributions and (2) for matching contributions equal to 50% of the sum of an employee's elective deferrals and employee after-tax contributions that do not exceed 10% of the employee's compensation. The plan provides that matching contributions are subject to the plan's 5-year graded vesting schedule and that matching contributions are forfeited and used to reduce employer contributions if associated elective deferrals or employee after-tax contributions are distributed to correct an ADP, ACP or multiple use test failure. For 1997, nonhighly compensated employees made employee after-tax contributions and no highly compensated employee made any employee after-tax contributions. Employee P received a matching contribution of \$ 4,000 (50% of \$ 8,000) and Employee Q received a matching contribution of \$ 4,750 (50% of \$ 9,500). Employees P and Q were 100% vested in 1997. It is determined that, for 1997, the ACP for highly compensated employees was not more than 125% of the ACP for nonhighly compensated employees, so that the ACP and multiple use tests would have been satisfied for 1997 without any corrective action.

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### Correction:

The same corrective actions are taken as in Example 1. In addition, in accordance with the plan's terms, corrective action is taken to forfeit Employee P's and Employee Q's matching contributions associated with their distributed excess contributions. Employee P's distributed excess contributions and associated matching contributions are \$ 2,037.50 and \$ 1,018.75, respectively. Employee Q's distributed excess contributions and associated matching contributions are \$ 3,537.50 and \$ 1,768.75, respectively. Thus, \$ 1,018.75 is forfeited from Employee P's account and \$ 1,768.75 is forfeited from Employee Q's account. In addition, the earnings on the forfeited amounts are also forfeited. It is determined that the respective earnings on the forfeited amount for Employee P is \$ 150 and for Employee Q is \$ 204. The total amount of the forfeitures of \$ 3,141.50 (Employee P's \$ 1,018.75 + \$ 150 and Employee Q's \$ 1,768.75 + \$ 204) is used to reduce contributions for 1999 and subsequent years.

### **.02 EXCLUSION OF ELIGIBLE EMPLOYEES.**

#### **1. EXCLUSION OF ELIGIBLE EMPLOYEES IN A 401(K) OR (M) PLAN.**

##### **(a) Correction Method.**

- (i) SVP Correction Method for Full Year Exclusion. Appendix A, section .05 sets forth the SVP correction method for the exclusion of an eligible employee from all contributions under a 401(k) or (m) plan for one or more full plan years. (See Example 4.) In section 2.02(1)(a)(ii) below, the SVP correction method for the exclusion of an eligible employee from all contributions under a 401(k) or (m) plan for a full year is expanded to include correction for the exclusion of an eligible employee from all contributions under a 401(k) or (m) plan for a partial plan year. This correction for a partial year exclusion may be used in conjunction with the correction for a full year exclusion.
- (ii) Expansion of SVP Correction Method to Partial Year Exclusion.
  - A. In General. The correction method in Appendix A, section .05 is expanded to cover an employee who was improperly excluded from making elective deferrals or employee after-tax contributions for a portion of a plan year or from receiving matching contributions (on either elective deferrals or employee after-tax contributions) for a portion of a plan year. In such case, a permitted correction method for the failure is for the employer to satisfy this

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section 2.02(1)(a)(ii). The employer makes a corrective contribution on behalf of the excluded employee that satisfies the vesting requirements and distribution limitations of § 401(k)(2)(B) and (C).

- B. **Elective Deferral Failures.** The appropriate corrective contribution for the failure to allow employees to make elective deferrals for a portion of the plan year is equal to the ADP of the employee's group (either highly or nonhighly compensated), determined prior to correction under this section 2.02(1)(a)(ii), multiplied by the employee's plan compensation for the portion of the year during which the employee was improperly excluded. The corrective contribution for the portion of the plan year during which the employee was improperly excluded from being eligible to make elective deferrals is reduced to the extent that (1) the sum of that contribution and any elective deferrals actually made by the employee for that year would exceed (2) the maximum elective deferrals permitted under the plan for the employee for that plan year (including the § 402(g) limit). The corrective contribution is adjusted for earnings. (See Examples 5 and 6.)
- C. **Employee After-tax and Matching Contribution Failures.** The appropriate corrective contribution for the failure to allow employees to make employee after-tax contributions or to receive matching contributions because the employee was precluded from making employee after-tax contributions or elective deferrals for a portion of the plan year is equal to the ACP of the employee's group (either highly or nonhighly compensated), determined prior to correction under this section 2.02(1)(a)(ii), multiplied by the employee's plan compensation for the portion of the year during which the employee was improperly excluded.

The corrective contribution is reduced to the extent that

- (1) the sum of that contribution and the actual total employee after-tax and matching contributions made by and for the employee for the plan year would exceed
- (2) the sum of the maximum employee after-tax contributions permitted under the plan for the employee for the plan year and the matching contributions that would have been made if the employee had made the maximum matchable contributions permitted under the plan for the employee for that plan year. The corrective contribution is adjusted for earnings.

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- D. Use of Prorated Compensation. For purposes of this paragraph (1)(a)(ii), for administrative convenience, in lieu of using the employee's actual plan compensation for the portion of the year during which the employee was improperly excluded, a pro rata portion of the employee's plan compensation that would have been taken into account for the plan year, if the employee had not been improperly excluded, may be used.
- E. Special Rule for Brief Exclusion from Elective Deferrals. An employer is not required to make a corrective contribution with respect to elective deferrals, as provided in section 2.02(1)(a)(ii)(B), (but is required to make a corrective contribution with respect to any employee after-tax and matching contributions, as provided in section 2.02(1)(a)(ii)(C)) for an employee for a plan year if the employee has been provided the opportunity to make elective deferrals under the plan for a period of at least the last 9 months in that plan year and during that period the employee had the opportunity to make elective deferrals in an amount not less than the maximum amount that would have been permitted if no failure had occurred. (See Example 7.)

### (b) Examples.

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#### **Example 4:**

Employer B maintains a 401(k) plan. The plan provides for matching contributions for eligible employees equal to 100% of elective deferrals that do not exceed 3% of an employee's compensation. The plan provides that employees who complete one year of service are eligible to participate in the plan on the next January 1 or July 1 entry date. Twelve employees (8 nonhighly compensated employees and 4 highly compensated employees) who had met the one year eligibility requirement after July 1, 1995 and before January 1, 1996 were inadvertently excluded from participating in the plan beginning on January 1, 1996. These employees were offered the opportunity to begin participating in the plan on January 1, 1997. For 1996, the ADP for the highly compensated employees was 8% and the ADP for the nonhighly compensated employees was 6%. In addition, for 1996, the ACP for the highly compensated employees was 2.5% and the ACP for the nonhighly compensated employees was 2%. The failure to include the 12 employees was discovered during 1998.

#### **Correction:**

Employer B uses the SVP correction method for full year exclusions to correct the failure to include the 12 eligible employees in the plan for the full plan year beginning January 1, 1996. Thus, Employer B makes a corrective contribution (that satisfies the

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vesting requirements and distribution limitations of § 401(k)(2)(B) and (C)) for each of the excluded employees. The contribution for each of the improperly excluded highly compensated employees is 10.5% (the highly compensated employees' ADP of 8% plus ACP of 2.5%) of the employee's plan compensation for the 1996 plan year (adjusted for earnings). The contribution for each of the improperly excluded nonhighly compensated employees is 8% (the nonhighly compensated employee's ADP of 6% plus ACP of 2%) of the employee's plan compensation for the 1996 plan year (adjusted for earnings).

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### Example 5:

Employer C maintains a 401(k) plan. The plan provides for matching contributions for each payroll period that are equal to 100% of an employee's elective deferrals that do not exceed 2% of the eligible employee's plan compensation during the payroll period. The plan does not provide for employee after-tax contributions. The plan provides that employees who complete one year of service are eligible to participate in the plan on the next January 1 or July 1 entry date. A nonhighly compensated employee who met the eligibility requirements and should have entered the plan on January 1, 1996 was not offered the opportunity to participate in the plan. In August of 1996, the error was discovered and Employer C offered the employee an election opportunity as of September 1, 1996. The employee made elective deferrals equal to 4% of the employee's plan compensation for each payroll period from September 1, 1996 through December 31, 1996 (resulting in elective deferrals of \$ 500). The employee's plan compensation for 1996 was \$ 36,000 (\$ 23,500 for the first eight months and \$ 12,500 for the last four months). Employer C made matching contributions equal to \$ 250 for the excluded employee, which is 2% of the employee's plan compensation for each payroll period from September 1, 1996 through December 31, 1996 (\$ 12,500). The ADP for nonhighly compensated employees for 1996 was 3% and the ACP for nonhighly compensated employees for 1996 was 1.8%.

### Correction:

Employer C uses the SVP correction method for partial year exclusions to correct the failure to include the eligible employee in the plan. Thus, Employer C makes a corrective contribution (that satisfies the vesting requirements and distribution limitations of § 401(k)(2)(B) and (C)) for the excluded employee. In determining the amount of corrective contributions (both for the elective deferral and for the matching contribution), for administrative convenience, in lieu of using actual plan compensation of \$ 23,500 for the period the employee was excluded, the employee's annual plan compensation is pro rated for the eight-month period that the employee was excluded from participating in the plan.

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The failure to provide the excluded employee the right to make elective deferrals is corrected by the employer making a corrective contribution on behalf of the employee that is equal to \$ 720 (the 3% ADP percentage for nonhighly compensated employees multiplied by \$ 24,000, which is 8/12ths of the employee's 1996 plan compensation of \$ 36,000), adjusted for earnings. In addition, to correct for the failure to receive the plan's matching contribution, a corrective contribution is made on behalf of the employee that is equal to \$ 432 (the 1.8% ACP for the nonhighly compensated group multiplied by \$ 24,000, which is 8/12ths of the employee's 1996 plan compensation of \$ 36,000), adjusted for earnings. Employer C determines that \$ 682, the sum of the actual matching contribution received by the employee for the plan year (\$ 250) and the corrective contribution to correct the matching contribution failure (\$ 432), does not exceed \$ 720, the maximum matching contribution available to the employee under the plan (2% of \$ 36,000) determined as if the employee had made the maximum matchable contributions. In addition to correcting the failure to include the eligible employee in the plan, Employer C reruns the ADP and ACP tests for 1996 (taking into account the corrective contribution and plan compensation for 1996 for the excluded employee) and determines that the tests were satisfied.

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### Example 6:

The facts are the same as in Example 5, except that the plan provides for matching contributions that are equal to 100% of an eligible employee's elective deferrals that do not exceed 2% of the employee's plan compensation for the plan year. Accordingly, the actual matching contribution made by Employer C for the excluded employee for the last four months of 1996 is \$ 500 (which is equal to 100% of the \$ 500 of elective deferrals made by the employee for the last four months of 1996).

### Correction:

The correction is the same as in Example 5, except that the corrective contribution made for the first 8 months of 1996 to correct the failure to make matching contributions is equal to \$ 220 (adjusted for earnings), instead of the \$ 432 (adjusted for earnings) in Example 5, because the corrective contribution is limited to the maximum matching contributions available under the plan for the employee for the plan year, \$ 720 (2% of \$ 36,000), reduced by the actual matching contributions made for the employee for the plan year, \$ 500.

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### Example 7:

The facts are the same as in Example 5, except that the error is discovered in March of 1996 and the employee was given the opportunity to make elective deferrals beginning



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on April 1, 1996. The amount of elective deferrals that the employee was given the opportunity to make during 1996 was not less than the maximum elective deferrals that the employee could have made if the employee had been given the opportunity to make elective deferrals beginning on January 1, 1996. The employee made elective deferrals equal to 4% of the employee's plan compensation for each payroll period from April 1, 1996 through December 31, 1996 of \$ 28,000 (resulting in elective deferrals of \$ 1,120). Employer C made a matching contribution equal to \$ 560, which is 2% of the employee's plan compensation for each payroll period from April 1, 1996 through December 31, 1996 (\$ 28,000). The employee's plan compensation for 1996 was \$ 36,000 (\$ 8,000 for the first three months and \$ 28,000 for the last nine months).

### **Correction:**

Employer C uses the SVP correction method for partial year exclusions to correct the failure to include an eligible employee in the plan. Because the employee was given an opportunity to make elective deferrals to the plan for at least the last 9 months of the plan year (and the amount of the elective deferrals that the employee had the opportunity to make was not less than the maximum elective deferrals that the employee could have made if the employee had been given the opportunity to make elective deferrals beginning on January 1, 1996), under the special rule set forth in section 2.02(1)(a)(ii)(E), Employer C is not required to make a corrective contribution for the failure to allow the employee to make elective deferrals.

In determining the amount of corrective contribution with respect to the failure to allow the employee to receive matching contributions, in lieu of using actual plan compensation of \$ 8,000 for the period the employee was excluded, the employee's annual plan compensation is pro rated for the three-month period that the employee was excluded from participating in the plan. Accordingly, a corrective contribution is made on behalf of the employee that is equal to \$ 160, which is the lesser of (i) \$ 162 (a matching contribution of 1.8% of \$ 9,000, which is 3/12ths of the employee's 1996 plan compensation of \$ 36,000), and (ii) \$ 160 (the excess of the maximum matching contribution for the entire plan year, which is equal to 2% of \$ 36,000, or \$ 720, over the matching contributions made after March 31, 1996, \$ 560). The contribution is adjusted for earnings.

### **(2) EXCLUSION OF ELIGIBLE EMPLOYEES IN A PROFIT-SHARING PLAN.**

#### **(a) Correction Methods.**

- (i) SVP Correction Method. Appendix A, section .05 sets forth the SVP correction method for correcting the exclusion of an eligible employee. In the case of a

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defined contribution plan, the SVP correction method is to make a contribution on behalf of the excluded employee. Section 2.02(2)(a)(ii) below clarifies the SVP correction method in the case of a profit-sharing or stock bonus plan that provides for nonelective contributions (within the meaning of § 1.401(k)-1(g)(10)).

- (ii) Clarification of SVP Correction Method for Profit-Sharing Plans. To correct for the exclusion of an eligible employee from nonelective contributions in a profit-sharing or stock bonus plan under the SVP correction method, an allocation amount is determined for each excluded employee on the same basis as the allocation amounts were determined for the other employees under the plan's allocation formula (e.g., the same ratio of allocation to compensation), taking into account all of the employee's relevant factors (e.g., compensation) under that formula for that year. The employer makes a corrective contribution on behalf of the excluded employee that is equal to the allocation amount for the excluded employee. The corrective contribution is adjusted for earnings. If, as a result of excluding an employee, an amount was improperly allocated to the account balance of an eligible employee who shared in the original allocation of the nonelective contribution, no reduction is made to the account balance of the employee who shared in the original allocation on account of the improper allocation. (See Example 8.)
- (iii) Reallocation Correction Method.
  - (A) In General. Subject to the limitations set forth in section 2.02(2)(a)(iii)(F) below, in addition to the SVP correction method, the exclusion of an eligible employee for a plan year from a profit-sharing or stock bonus plan that provides for nonelective contributions may be corrected using the reallocation correction method set forth in this section 2.02(2)(a)(iii). Under the reallocation correction method, the account balance of the excluded employee is increased as provided in paragraph (2)(a)(iii)(B) below, the account balances of other employees are reduced as provided in paragraph (2)(a)(iii)(C) below, and the increases and reductions are reconciled, as necessary, as provided in paragraph (2)(a)(iii)(D) below. (See Examples 9 and 10.)
  - (B) Increase in Account Balance of Excluded Employee. The account balance of the excluded employee is increased by an amount that is equal to the allocation the employee would have received had the employee shared in the allocation of the nonelective contribution. The amount is adjusted for earnings.

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### (C) Reduction in Account Balances of Other Employees.

- (1) The account balance of each employee who was an eligible employee who shared in the original allocation of the nonelective contribution is reduced by the excess, if any, of (I) the employee's allocation of that contribution over (II) the amount that would have been allocated to that employee had the failure not occurred. This amount is adjusted for earnings taking into account the rules set forth in section 2.02(2)(a)(iii)(C)(2) and (3) below. The amount after adjustment for earnings is limited in accordance with section 2.02(2)(a)(iii)(C)(4) below.
  - (2) This paragraph (2)(a)(iii)(C)(2) applies if most of the employees with account balances that are being reduced are nonhighly compensated employees. If there has been an overall gain for the period from the date of the original allocation of the contribution through the date of correction, no adjustment for earnings is required to the amount determined under section 2.02(2)(a)(iii)(C)(1) for the employee. If the amount for the employee is being adjusted for earnings and the plan permits investment of account balances in more than one investment fund, for administrative convenience, the reduction to the employee's account balance may be adjusted by the lowest earnings rate of any fund for the period from the date of the original allocation of the contribution through the date of correction.
  - (3) If an employee's account balance is reduced and the original allocation was made to more than one investment fund or there was a subsequent distribution or transfer from the fund receiving the original allocation, then reasonable, consistent assumptions are used to determine the earnings adjustment.
  - (4) The amount determined in section 2.02(2)(a)(iii)(C)(1) for an employee after the application of section 2.02(2)(a)(iii)(C)(2) and (3) may not exceed the account balance of the employee on the date of correction, and the employee is permitted to retain any distribution made prior to the date of correction.
- (D) Reconciliation of Increases and Reductions. If the aggregate amount of the increases under section 2.02(2)(a)(iii)(B) exceeds the aggregate amount of the reductions under section 2.02(2)(a)(iii)(C), the employer makes a corrective contribution to the plan for the amount of the excess. If the aggregate amount of the reductions under section 2.02(2)(a)(iii)(C) exceeds

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the aggregate amount of the increases under section 2.02(2)(a)(iii)(B), then the amount by which each employee's account balance is reduced under section 2.02(2)(a)(iii)(C) is decreased on a pro rata basis.

- (E) Reductions Among Multiple Investment Funds. If an employee's account balance is reduced and the employee's account balance is invested in more than one investment fund, then the reduction may be made from the investment funds selected in any reasonable manner.
- (F) Limitations on Use of Reallocation Correction Method. If any employee would be permitted to retain any distribution pursuant to section 2.02(2)(a)(iii)(C)(4), then the reallocation correction method may not be used unless most of the employees who would be permitted to retain a distribution are nonhighly compensated employees.

### (b) Examples.

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#### Example 8:

Employer D maintains a profit-sharing plan that provides for discretionary nonelective employer contributions. The plan provides that the employer's contributions are allocated to account balances in the ratio that each eligible employee's compensation for the plan year bears to the compensation of all eligible employees for the plan year and, therefore, the only relevant factor for determining an allocation is the employee's compensation. The plan provides for self-directed investments among four investment funds and daily valuations of account balances. For the 1997 plan year, Employer D made a contribution to the plan of a fixed dollar amount. However, five employees who met the eligibility requirements were inadvertently excluded from participating in the plan. The contribution resulted in an allocation on behalf of each of the eligible employees, other than the excluded employees, equal to 10% of compensation. Most of the employees who received allocations under the plan for the year of the failure were nonhighly compensated employees. No distributions have been made from the plan since 1997. If the five excluded employees had shared in the original allocation, the allocation made on behalf of each employee would have equaled 9% of compensation. The excluded employees began participating in the plan in the 1998 plan year.

#### Correction:

Employer D uses the SVP correction method to correct the failure to include the five eligible employees. Thus, Employer D makes a corrective contribution to the plan. The amount of the corrective contribution on behalf of the five excluded employees for the

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1997 plan year is equal to 10% of compensation of each excluded employee, the same allocation that was made for other eligible employees, adjusted for earnings. The excluded employees receive an allocation equal to 10% of compensation (adjusted for earnings) even though, had the excluded employees originally shared in the allocation for the 1997 contribution, their account balances, as well as those of the other eligible employees, would have received an allocation equal to only 9% of compensation.

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### **Example 9:**

The facts are the same as in Example 8.

### **Correction:**

Employer D uses the reallocation correction method to correct the failure to include the five eligible employees. Thus, the account balances are adjusted to reflect what would have resulted from the correct allocation of the employer contribution for the 1997 plan year among all eligible employees, including the five excluded employees. The inclusion of the excluded employees in the allocation of that contribution would have resulted in each eligible employee, including each excluded employee, receiving an allocation equal to 9% of compensation. Accordingly, the account balance of each excluded employee is increased by 9% of the employee's 1997 compensation, adjusted for earnings. The account balance of each of the eligible employees other than the excluded employees is reduced by 1% of the employee's 1997 compensation, adjusted for earnings. Employer D determines the adjustment for earnings using the earnings rate of each eligible employee's excess allocation (using reasonable, consistent assumptions). Accordingly, for an employee who shared in the original allocation and directed the investment of the allocation into more than one investment fund or who subsequently transferred a portion of a fund that had been credited with a portion of the 1997 allocation to another fund, reasonable, consistent assumptions are followed to determine the adjustment for earnings. It is determined that the total of the initially determined reductions in account balances exceeds the total of the required increases in account balances. Accordingly, these initially determined reductions are decreased pro rata so that the total of the actual reductions in account balances equals the total of the increases in the account balances, and Employer D does not make any corrective contribution. The reduction from the account balances are made on a pro rata basis among all of the funds in which each employee's account balance is invested.

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### **Example 10:**

The facts are the same as in Example 8.

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### **Correction:**

The correction is the same as in Example 9, except that, because most of the employees whose account balances are being reduced are nonhighly compensated employees, for administrative convenience, Employer D uses the earnings rate of the fund with the lowest earnings rate for the period of the failure to adjust the reduction to each account balance. It is determined that the aggregate amount (adjusted for earnings) by which the account balances of the excluded employees is increased exceeds the aggregate amount (adjusted for earnings) by which the other employees' account balances are reduced. Accordingly, Employer D makes a contribution to the plan in an amount equal to the excess. The reduction from account balances is made on a pro rata basis among all of the funds in which each employee's account balance is invested.

### **.03 VESTING FAILURES.**

#### **1. CORRECTION METHODS.**

- (a) Contribution Correction Method. A failure in a defined contribution plan to apply the proper vesting percentage to an employee's account balance that results in forfeiture of too large a portion of the employee's account balance may be corrected using the contribution correction method set forth in this paragraph. The employer makes a corrective contribution on behalf of the employee whose account balance was improperly forfeited in an amount equal to the improper forfeiture. The corrective contribution is adjusted for earnings. If, as a result of the improper forfeiture, an amount was improperly allocated to the account balance of another employee, no reduction is made to the account balance of that employee. (See Example 11.)
- (b) Reallocation Correction Method. In addition to the contribution correction method, in a defined contribution plan under which forfeitures of account balances are reallocated among the account balances of the other eligible employees in the plan, a failure to apply the proper vesting percentage to an employee's account balance which results in forfeiture of too large a portion of the employee's account balance may be corrected under the reallocation correction method set forth in this paragraph. A corrective reallocation is made in accordance with the reallocation correction method set forth in section 2.02(2)(a)(iii), subject to the limitations set forth in section 2.02(2)(a)(iii)(F). In applying section 2.02(2)(a)(iii)(B), the account balance of the employee who incurred the improper forfeiture is increased by an amount equal to the amount of the improper forfeiture and the amount is adjusted for earnings. In applying section 2.02(2)(a)(iii)(C)(1), the account balance of each

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employee who shared in the allocation of the improper forfeiture is reduced by the amount of the improper forfeiture that was allocated to that employee's account. The earnings adjustments for the account balances that are being reduced are determined in accordance with sections 2.02(2)(a)(iii)(C)(2) and (3) and the reductions after adjustments for earnings are limited in accordance with section 2.02(2)(a)(iii)(C)(4). In accordance with section 2.02(2)(a)(iii)(D), if the aggregate amount of the increases exceeds the aggregate amount of the reductions, the employer makes a corrective contribution to the plan for the amount of the excess. In accordance with section 2.02(2)(a)(iii)(D), if the aggregate amount of the reductions exceeds the aggregate amount of the increases, then the amount by which each employee's account balance is reduced is decreased on a pro rata basis. (See Example 12.)

### **(2) EXAMPLES.**

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#### **Example 11:**

Employer E maintains a profit-sharing plan that provides for nonelective contributions. The plan provides for self-directed investments among four investment funds and daily valuation of account balances. The plan provides that forfeitures of account balances are reallocated among the account balances of other eligible employees on the basis of compensation. During the 1997 plan year, Employee R terminated employment with Employer E and elected and received a single-sum distribution of the vested portion of his account balance. No other distributions have been made since 1997. However, an incorrect determination of Employee R's vested percentage was made resulting in Employee R receiving a distribution of less than the amount to which he was entitled under the plan. The remaining portion of Employee R's account balance was forfeited and reallocated (and these reallocations were not affected by the limitations of § 415). Most of the employees who received allocations of the improper forfeiture were nonhighly compensated employees.

#### **Correction:**

Employer E uses the contribution correction method to correct the improper forfeiture. Thus, Employer E makes a contribution on behalf of Employee R equal to the incorrectly forfeited amount (adjusted for earnings) and Employee R's account balance is increased accordingly. No reduction is made from the account balances of the employees who received an allocation of the improper forfeiture.

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#### **Example 12:**

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The facts are the same as in Example 11.

### **Correction:**

Employer E uses the reallocation correction method to correct the improper forfeiture. Thus, Employee R's account balance is increased by the amount that was improperly forfeited (adjusted for earnings). The account of each employee who shared in the allocation of the improper forfeiture is reduced by the amount of the improper forfeiture that was allocated to that employee's account (adjusted for earnings). Because most of the employees whose account balances are being reduced are nonhighly compensated employees, for administrative convenience, Employer E uses the earnings rate of the fund with the lowest earnings rate for the period of the failure to adjust the reduction to each account balance. It is determined that the amount (adjusted for earnings) by which the account balance of Employee R is increased exceeds the aggregate amount (adjusted for earnings) by which the other employees' account balances are reduced. Accordingly, Employer E makes a contribution to the plan in an amount equal to the excess. The reduction from the account balances is made on a pro rata basis among all of the funds in which each employee's account balance is invested.

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### **.04 § 415 FAILURES.**

#### **(1) FAILURES RELATING TO A § 415(B) EXCESS.**

##### **(a) Correction Methods.**

- (i) Return of Overpayment Correction Method. Overpayments as a result of amounts being paid in excess of the limits of § 415(b) may be corrected using the return of overpayment correction method set forth in this paragraph (1)(a)(i). The employer takes reasonable steps to have the Overpayment (with appropriate interest) returned by the recipient to the plan and reduces future benefit payments (if any) due to the employee to reflect § 415(b). To the extent the amount returned by the recipient is less than the Overpayment, adjusted for earnings at the plan's earnings rate, then the employer or another person contributes the difference to the plan. In addition, in accordance with section 6.02(4)(a), the employer must notify the recipient that the Overpayment was not eligible for favorable tax treatment accorded to distributions from qualified plans (and, specifically, was not eligible for tax-free rollover). (See Examples 15 and 16.)
- (ii) Adjustment of Future Payments Correction Method.



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- (A) In General. In addition to the return of overpayment correction method, in the case of plan benefits that are being distributed in the form of periodic payments, Overpayments as a result of amounts being paid in excess of the limits in § 415(b) may be corrected by using the adjustment of future payments correction method set forth in this paragraph (1)(a)(ii). Future payments to the recipient are reduced so that they do not exceed the § 415(b) maximum limit and an additional reduction is made to recoup the Overpayment (over a period not longer than the remaining payment period) so that the actuarial present value of the additional reduction is equal to the Overpayment plus interest at the interest rate used by the plan to determine actuarial equivalence. (See Examples 13 and 14.)
- (B) Joint and Survivor Annuity Payments. If the employee is receiving payments in the form of a joint and survivor annuity, with the employee's spouse to receive a life annuity upon the employee's death equal to a percentage (e.g., 75%) of the amount being paid to the employee, the reduction of future annuity payments to reflect § 415(b) reduces the amount of benefits payable during the lives of both the employee and spouse, but any reduction to recoup Overpayments made to the employee does not reduce the amount of the spouse's survivor benefit. Thus, the spouse's benefit will be based on the previous specified percentage (e.g., 75%) of the maximum permitted under § 415(b), instead of the reduced annual periodic amount payable to the employee.
- (C) Overpayment Not Treated as an Excess Amount. An Overpayment corrected under this adjustment of future payment correction method, is not treated as an Excess Amount as defined in section 5.01(3).

### (b) Examples.

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#### **Example 13:**

Employer F maintains a defined benefit plan funded solely through employer contributions. The plan provides that the benefits of employees are limited to the maximum amount permitted under § 415(b), disregarding cost-of-living adjustments under § 415(d) after benefit payments have commenced. At the beginning of the 1998 plan year, Employee S retired and started receiving an annual straight life annuity of \$ 140,000 from the plan. Due to an administrative error, the annual amount received by Employee S for 1998 included an Overpayment of \$ 10,000 (because the § 415(b)(1)(A) limit for 1998 was \$ 130,000). This error was discovered at the beginning of 1999.

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### **Correction:**

Employer F uses the adjustment of future payments correction method to correct the failure to satisfy the limit in § 415(b). Future annuity benefit payments to Employee S are reduced so that they do not exceed the § 415(b) maximum limit, and, in addition, Employee S's future benefit payments from the plan are actuarially reduced to recoup the Overpayment. Accordingly, Employee S's future benefit payments from the plan are reduced to \$ 130,000 and further reduced by \$ 1,000 annually for life, beginning in 1999. The annual benefit amount is reduced by \$ 1,000 annually for life because, for Employee S, the actuarial present value of a benefit of \$ 1,000 annually for life commencing in 1999 is equal to the sum of \$ 10,000 and interest at the rate used by the plan to determine actuarial equivalence beginning with the date of the first Overpayment and ending with the date the reduced annuity payment begins. Thus, Employee S's remaining benefit payments are reduced so that Employee S receives \$ 129,000 for 1999, and for each year thereafter.

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### **Example 14:**

The facts are the same as in Example 13.

### **Correction:**

Employer F uses the adjustments of future payments correction method to correct the § 415(b) failure, by recouping the entire excess payment made in 1998 from Employee S's remaining benefit payments for 1999. Thus, Employee S's annual annuity benefit for 1999 is reduced to \$ 119,400 to reflect the excess benefit amounts (increased by interest) that were paid from the plan to Employee S during the 1998 plan year. Beginning in 2000, Employee S begins to receive annual benefit payments of \$ 130,000.

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### **Example 15:**

The facts are the same as in Example 13, except that the benefit was paid to Employee S in the form of a single-sum distribution in 1998, which exceeded the maximum § 415(b) limits by \$ 110,000.

### **Correction:**

Employer F uses the return of overpayment correction method to correct the § 415 (b) failure. Thus, Employer F notifies Employee S of the \$ 110,000 Overpayment and that

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the Overpayment was not eligible for favorable tax treatment accorded to distributions from qualified plans (and, specifically, was not eligible for tax-free rollover). The notice also informs Employee S that the Overpayment (with interest at the rate used by the plan to calculate the single-sum payment) is owed to the plan. Employer F takes reasonable steps to have the Overpayment (with interest at the rate used by the plan to calculate the single-sum payment) paid to the plan. Employee S pays the \$ 110,000 (plus the requested interest) to the plan. It is determined that the plan's earnings rate for the relevant period was 2 percentage points more than the rate used by the plan to calculate the single-sum payment. Accordingly, Employer F contributes the difference to the plan.

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### Example 16:

The facts are the same as in Example 15.

### Correction:

Employer F uses the return of overpayment correction method to correct the § 415(b) failure. Thus, Employer F notifies Employee S of the \$ 110,000 Overpayment and that the Overpayment was not eligible for favorable tax treatment accorded to distributions from qualified plans (and, specifically, was not eligible for tax-free rollover). The notice also informs Employee S that the Overpayment (with interest at the rate used by the plan to calculate the single-sum payment) is owed to the plan. Employer F takes reasonable steps to have the Overpayment (with interest at the rate used by the plan to calculate the single-sum payment) paid to the plan. As a result of Employer F's recovery efforts, some, but not all, of the Overpayment (with interest) is recovered from Employee S. It is determined that the amount returned by Employee S to the plan is less than the Overpayment adjusted for earnings at the plan's earnings rate. Accordingly, Employer F contributes the difference to the plan.

### **(2) FAILURES RELATING TO A § 415(C) EXCESS.**

#### **(a) Correction Methods.**

- (i) SVP Correction Method. Appendix A, section .08 sets forth the SVP correction method for correcting the failure to satisfy the § 415(c) limits on annual additions.
- (ii) Forfeiture Correction Method. In addition to the SVP correction method, the failure to satisfy § 415(c) with respect to a nonhighly compensated employee (A) who in the limitation year of the failure had annual additions consisting of

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both (I) either elective deferrals or employee after-tax contributions or both and (II) either matching or nonelective contributions or both, (B) for whom the matching and nonelective contributions equal or exceed the portion of the employee's annual addition that exceeds the limits under § 415(c) ("§ 415(c) excess") for the limitation year, and (C) who has terminated with no vested interest in the matching and nonelective contributions (and has not been reemployed at the time of the correction), may be corrected by using the forfeiture correction method set forth in this paragraph. The § 415(c) excess is deemed to consist solely of the matching and nonelective contributions. If the employee's § 415(c) excess (adjusted for earnings) has previously been forfeited, the § 415(c) failure is deemed to be corrected. If the § 415(c) excess (adjusted for earnings) has not been forfeited, that amount is placed in an unallocated account, similar to the suspense account described in § 1.415-6(b)(6)(iii), to be used to reduce employer contributions in succeeding year(s) (or if the amount would have been allocated to other employees who were in the plan for the year of the failure if the failure had not occurred, then that amount is reallocated to the other employees in accordance with the plan's allocation formula). Note that while this correction method will permit more favorable tax treatment of elective deferrals for the employee than the SVP correction method, this correction method could be less favorable to the employee in certain cases, for example, if the employee is subsequently reemployed and becomes vested. (See Examples 17 and 18.)

- (iii) Return of Overpayment Correction Method. A failure to satisfy § 415(c) that includes a distribution of the § 415(c) excess attributable to nonelective contributions and matching contributions may be corrected using the return of overpayment correction method set forth in this paragraph. The employer takes reasonable steps to have the Overpayment (i.e., the distribution of the § 415(c) excess adjusted for earnings to the date of the distribution), plus appropriate interest from the date of the distribution to the date of the repayment, returned by the employee to the plan. To the extent the amount returned by the employee is less than the Overpayment adjusted for earnings at the plan's earnings rate, then the employer or another person contributes the difference to the plan. The Overpayment, adjusted for earnings at the plan's earnings rate to the date of the repayment, is to be placed in an unallocated account, similar to the suspense account described in § 1.415-6(b)(6)(iii), to be used to reduce employer contributions in succeeding year(s) (or if the amount would have been allocated to other eligible employees who were in the plan for the year of the failure if the failure had not occurred, then that amount is reallocated to the other eligible employees in accordance with the plan's allocation formula). In addition, the employer must notify the

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employee that the Overpayment was not eligible for favorable tax treatment accorded to distributions from qualified plans (and, specifically, was not eligible for tax-free rollover).

### (b) Examples.

#### **Example 17:**

Employer G maintains a 401(k) plan. The plan provides for nonelective employer contributions, elective deferrals, and employee after-tax contributions. The plan provides that the nonelective contributions vest under a 5-year cliff vesting schedule. The plan provides that when an employee terminates employment, the employee's nonvested account balance is forfeited five years after a distribution of the employee's vested account balance and that forfeitures are used to reduce employer contributions. For the 1998 limitation year, the annual additions made on behalf of two nonhighly compensated employees in the plan, Employees T and U, exceeded the limit in § 415(c). For the 1998 limitation year, Employee T had § 415 compensation of \$ 60,000, and, accordingly, a § 415(c)(1)(B) limit of \$ 15,000. Employee T made elective deferrals and employee after-tax contributions. For the 1998 limitation year, Employee U had § 415 compensation of \$ 40,000, and, accordingly, a § 415(c)(1)(B) limit of \$ 10,000. Employee U made elective deferrals. Also, on January 1, 1999, Employee U, who had three years of service with Employer G, terminated his employment and received his entire vested account balance (which consisted of his elective deferrals). The annual additions for Employees T and U consisted of:

	<b>T</b>	<b>U</b>
Nonelective contributions	<b>\$7,500</b>	<b>\$ 4,500</b>
Elective Deferrals	<b>\$10,000</b>	<b>\$5,800</b>
After-Tax Contributions	<b>\$500</b>	<b>\$0</b>
Total Contributions	<b>\$ 18,000</b>	<b>\$10,300</b>
§ 415(c) Limit	<b>\$15,000</b>	<b>\$10,000</b>
§ 415(c) Excess	<b>\$3,000</b>	<b>\$300</b>

Employer G uses the SVP correction method to correct the § 415(c) excess with respect to Employee T (i.e., \$ 3,000). Thus, a distribution of plan assets (and corresponding reduction of the account balance) consisting of \$ 500 (adjusted for earnings) of employee after-tax contributions and \$ 2,500 (adjusted for earnings) of elective deferrals is made to Employee T. Employer G uses the forfeiture correction method to

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correct the § 415(c) excess with respect to Employee U. Thus, the § 415(c) excess is deemed to consist solely of the nonelective contributions. Accordingly, Employee U's nonvested account balance is reduced by \$ 300 (adjusted for earnings) which is placed in an unallocated account, similar to the suspense account described in § 1.415-6(b)(6)(iii), to be used to reduce employer contributions in succeeding year(s). After correction, it is determined that the ADP and ACP tests for 1998 were satisfied.

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### Example 18:

Employer H maintains a 401(k) plan. The plan provides for nonelective employer contributions, matching contributions and elective deferrals. The plan provides for matching contributions that are equal to 100% of an employee's elective deferrals that do not exceed 8% of the employee's plan compensation for the plan year. For the 1998 limitation year, Employee V had § 415 compensation of \$ 50,000, and, accordingly, a § 415(c)(1)(B) limit of \$ 12,500. During that limitation year, the annual additions for Employee V totaled \$ 15,000, consisting of \$ 5,000 in elective deferrals, a \$ 4,000 matching contribution (8% of \$ 50,000), and a \$ 6,000 nonelective employer contribution. Thus, the annual additions for Employee V exceeded the § 415(c) limit by \$ 2,500.

### Correction:

Employer H uses the SVP correction method to correct the § 415(c) excess with respect to Employee V (i.e., \$ 2,500). Accordingly, \$ 1,000 of the unmatched elective deferrals (adjusted for earnings) are distributed to Employee V. The remaining \$ 1,500 excess is apportioned equally between the elective deferrals and the associated matching employer contributions, so Employee V's account balance is further reduced by distributing to Employee V \$ 750 (adjusted for earnings) of the elective deferrals and forfeiting \$ 750 (adjusted for earnings) of the associated employer matching contributions. The forfeited matching contributions are placed in an unallocated account, similar to the suspense account described in § 1.415-6(b)(6)(iii), to be used to reduce employer contributions in succeeding year(s). After correction, it is determined that the ADP and ACP tests for 1998 were satisfied.

## **.05 CORRECTION OF OTHER OVERPAYMENT FAILURES.**

An Overpayment, other than one described in section 2.04(1) (relating to a § 415(b) excess) or section 2.04(2) (relating to a § 415(c) excess), may be corrected in accordance with this section 2.05. An Overpayment from a defined benefit plan is corrected in accordance with the rules in section 2.04(1). An Overpayment from a

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defined contribution plan is corrected in accordance with the rules in section 2.04(2)(a)(iii).

### **.06 § 401(A)(17) FAILURES.**

#### **1. REDUCTION OF ACCOUNT BALANCE CORRECTION METHOD.**

The allocation of contributions or forfeitures under a defined contribution plan for a plan year on the basis of compensation in excess of the limit under § 401(a)(17) for the plan year may be corrected using the reduction of account balance correction method set forth in this paragraph. The account balance of an employee who received an allocation on the basis of compensation in excess of the § 401(a)(17) limit is reduced by this improperly allocated amount (adjusted for earnings). If the improperly allocated amount would have been allocated to other employees in the year of the failure if the failure had not occurred, then that amount (adjusted for earnings) is reallocated to those employees in accordance with the plan's allocation formula. If the improperly allocated amount would not have been allocated to other employees absent the failure, that amount (adjusted for earnings) is placed in an unallocated account, similar to the suspense account described in § 1.415-6(b)(6)(iii), to be used to reduce employer contributions in succeeding year(s). For example, if a plan provides for a fixed level of employer contributions for each eligible employee, and the plan provides that forfeitures are used to reduce future employer contributions, the improperly allocated amount (adjusted for earnings) would be used to reduce future employer contributions. (See Example 19.) If a payment was made to an employee and that payment was attributable to an improperly allocated amount, then it is an Overpayment defined in section 2.05(2) that must be corrected (see section 2.05(1)).

#### **(2) EXAMPLE.**

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##### **Example 19:**

Employer J maintains a money purchase pension plan. Under the plan, an eligible employee is entitled to an employer contribution of 8% of the employee's compensation up to the § 401(a)(17) limit (\$ 160,000 for 1998). During the 1998 plan year, an eligible employee, Employee W, inadvertently was credited with a contribution based on compensation above the § 401(a)(17) limit. Employee W's compensation for 1998 was \$ 220,000. Employee W received a contribution of \$ 17,600 for 1998 (8% of \$ 220,000), rather than the contribution of \$ 12,800 (8% of \$ 160,000) provided by the plan for that year, resulting in an improper allocation of \$ 4,800.

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### **Correction:**

The § 401(a)(17) failure is corrected using the reduction of account balance method by reducing Employee W's account balance by \$ 4,800 (adjusted for earnings) and crediting that amount to an unallocated account, similar to the suspense account described in § 1.415-6(b)(6)(iii), to be used to reduce employer contributions in succeeding year(s).

### **.07 CORRECTION BY AMENDMENT UNDER WALK-IN CAP.**

#### **1. § 401(A)(17) FAILURES.**

(a) Contribution Correction Method. In addition to the reduction of account balance correction method under section 2.06 of this Appendix B, an employer may correct a § 401(a)(17) failure for a plan year under a defined contribution plan under the Walk-in Closing Agreement Program ("Walk-in CAP") (in accordance with the requirements of section 11) by using the contribution correction method set forth in this paragraph. The employer contributes an additional amount on behalf of each of the other employees (excluding each employee for whom there was a § 401(a)(17) failure) who received an allocation for the year of the failure, amending the plan (as necessary) to provide for the additional allocation. The amount contributed for an employee is equal to the employee's plan compensation for the year of the failure multiplied by a fraction, the numerator of which is the improperly allocated amount made on behalf of the employee with the largest improperly allocated amount, and the denominator of which is the limit under § 401(a)(17) applicable to the year of the failure. The resulting additional amount for each of the other employees is adjusted for earnings. (See Example 20.)

#### **(b) Examples.**

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#### **Example 20:**

The facts are the same as in Example 19.

### **Correction:**

Employer J corrects the failure under Walk-in CAP using the contribution correction method by (1) amending the plan to increase the contribution percentage for all eligible employees (other than Employee W) for the 1998 plan year and (2) contributing an additional amount (adjusted for earnings) for those employees for that plan year. To



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determine the increase in the plan's contribution percentage (and the additional amount contributed on behalf of each eligible employee), the improperly allocated amount (\$ 4,800) is divided by the § 401(a)(17) limit for 1998 (\$ 160,000). Accordingly, the plan is amended to increase the contribution percentage by 3 percentage points (\$ 4,800/\$ 160,000) from 8% to 11%. In addition, each eligible employee for the 1998 plan year (other than Employee W) receives an additional contribution of 3% multiplied by that employee's plan compensation for 1998. This additional contribution is adjusted for earnings.

### **2. HARDSHIP DISTRIBUTION FAILURES.**

#### **(a) Plan Amendment Correction Method.**

The Operational Failure of making hardship distributions to employees under a plan that does not provide for hardship distributions may be corrected under Walk-in CAP (in accordance with the requirements of section 11) using the plan amendment correction method set forth in this paragraph. The plan is amended retroactively to provide for the hardship distributions that were made available. This paragraph does not apply unless (i) the amendment satisfies § 401(a), and (ii) the plan as amended would have satisfied the qualification requirements of § 401(a) (including the requirements applicable to hardship distributions under § 401(k), if applicable) had the amendment been adopted when hardship distributions were first made available. (See Example 21.)

#### **(b) Example.**

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#### **Example 21:**

Employer K, a for-profit corporation, maintains a 401(k) plan. Although plan provisions in 1998 did not provide for hardship distributions, beginning in 1998 hardship distributions of amounts allowed to be distributed under § 401(k) were made currently and effectively available to all employees (within the meaning of § 1.401(a)(4)-4). The standard used to determine hardship satisfied the deemed hardship distribution standards in § 1.401(k)-1(d)(2). Hardship distributions were made to a number of employees during the 1998 and 1999 plan years, creating an Operational Failure. The failure was discovered in 2000.

#### **Correction:**

Employer K corrects the failure through Walk-in CAP by adopting a plan amendment, effective January 1, 1998, to provide a hardship distribution option that satisfies the rules applicable to hardship distributions in § 1.401(k)-1(d)(2). The amendment provides

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that the hardship distribution option is available to all employees. Thus, the amendment satisfies § 401(a), and the plan as amended in 2000 would have satisfied § 401(a) (including § 1.401(a)(4)-4 and the requirements applicable to hardship distributions under § 401(k)) if the amendment had been adopted in 1998.

### **SECTION 3. EARNINGS ADJUSTMENT METHODS AND EXAMPLES**

#### **.01 EARNINGS ADJUSTMENT METHODS.**

##### **1. IN GENERAL.**

- (a) Under section 6.02(5)(a), whenever the appropriate correction method for an Operational Failure in a defined contribution plan includes a corrective contribution or allocation that increases one or more employees' account balances (now or in the future), the contribution or allocation is adjusted for earnings and forfeitures. This section 3 provides earnings adjustment methods (but not forfeiture adjustment methods) that may be used by an employer to adjust a corrective contribution or allocation for earnings in a defined contribution plan. Consequently, these earnings adjustment methods may be used to determine the earnings adjustments for corrective contributions or allocations made under the correction methods in section 2 and under the SVP correction methods in Appendix A. If an earnings adjustment method in this section 3 is used to adjust a corrective contribution or allocation, that adjustment is treated as satisfying the earnings adjustment requirement of section 6.02(5)(a). Other earnings adjustment methods, different from those illustrated in this section 3, may also be appropriate for adjusting corrective contributions or allocations to reflect earnings.
- (b) Under the earnings adjustment methods of this section 3, a corrective contribution or allocation that increases an employee's account balance is adjusted to reflect an "earnings amount" that is based on the earnings rate(s) (determined under section 3.01(3)) for the period of the failure (determined under section 3.01(2)). The earnings amount is allocated in accordance with section 3.01(4).
- (c) The rule in section 6.02(6)(a) permitting reasonable estimates in certain circumstances applies for purposes of this section 3. For this purpose, a determination of earnings made in accordance with the rules of administrative convenience set forth in this section 3 is treated as a precise determination of

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earnings. Thus, if the probable difference between an approximate determination of earnings and a determination of earnings under this section 3 is insignificant and the administrative cost of a precise determination would significantly exceed the probable difference, reasonable estimates may be used in calculating the appropriate earnings.

- (d) This section 3 does not apply to corrective distributions or corrective reductions in account balances. Thus, for example, while this section 3 applies in increasing the account balance of an improperly excluded employee to correct the exclusion of the employee under the reallocation correction method described in section 2.02(2)(a)(iii)(B), this section 3 does not apply in reducing the account balances of other employees under the reallocation correction method. (See section 2.02(2)(a)(iii)(C) for rules that apply to the earnings adjustments for such reductions.) In addition, this section 3 does not apply in determining earnings adjustments under the one-to-one correction method described in section 2.01(1)(b)(iii).

### **2. PERIOD OF THE FAILURE.**

- (a) General Rule. For purposes of this section 3, the "period of the failure" is the period from the date that the failure began through the date of correction. For example, in the case of an improper forfeiture of an employee's account balance, the beginning of the period of the failure is the date as of which the account balance was improperly reduced.
- (b) Rules for Beginning Date for Exclusion of Eligible Employees from Plan.
- (i) General Rule. In the case of an exclusion of an eligible employee from a plan contribution, the beginning of the period of the failure is the date on which contributions of the same type (e.g., elective deferrals, matching contributions, or discretionary nonelective employer contributions) were made for other employees for the year of the failure. In the case of an exclusion of an eligible employee from an allocation of a forfeiture, the beginning of the period of the failure is the date on which forfeitures were allocated to other employees for the year of the failure.
- (ii) Exclusion from a 401(k) or (m) Plan. For administrative convenience, for purposes of calculating the earnings rate for corrective contributions for a plan year (or the portion of the plan year) during which an employee was improperly excluded from making periodic elective deferrals or employee after-tax contributions, or from receiving periodic matching contributions,

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the employer may treat the date on which the contributions would have been made as the midpoint of the plan year (or the midpoint of the portion of the plan year) for which the failure occurred. Alternatively, in this case, the employer may treat the date on which the contributions would have been made as the first date of the plan year (or the portion of the plan year) during which an employee was excluded, provided that the earnings rate used is one half of the earnings rate applicable under section 3.01(3) for the plan year (or the portion of the plan year) for which the failure occurred.

### **3. EARNINGS RATE.**

- (a) General Rule. For purposes of this section 3, the earnings rate generally is based on the investment results that would have applied to the corrective contribution or allocation if the failure had not occurred.
- (b) Multiple Investment Funds. If a plan permits employees to direct the investment of account balances into more than one investment fund, the earnings rate is based on the rate applicable to the employee's investment choices for the period of the failure. In accordance with section 6.02(5)(a), for administrative convenience, if most of the employees for whom the corrective contribution or allocation is made are nonhighly compensated employees, the rate of return of the fund with the highest earnings rate under the plan for the period of the failure may be used to determine the earnings rate for all corrective contributions or allocations. If the employee had not made any applicable investment choices, the earnings rate may be based on the earnings rate under the plan as a whole (i.e., the average of the rates earned by all of the funds in the valuation periods during the period of the failure weighted by the portion of the plan assets invested in the various funds during the period of the failure).
- (c) Other Simplifying Assumptions. For administrative convenience, the earnings rate applicable to the corrective contribution or allocation for a valuation period with respect to any investment fund may be assumed to be the actual earnings rate for the plan's investments in that fund during that valuation period. For example, the earnings rate may be determined without regard to any special investment provisions that vary according to the size of the fund. Further, the earnings rate applicable to the corrective contribution or allocation for a portion of a valuation period may be a pro rata portion of the earnings rate for the entire valuation period, unless the application of this rule would result in either a significant understatement or overstatement of the actual earnings during that portion of the valuation period.

## EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

### **4. ALLOCATION METHODS.**

- (a) In General. For purposes of this section 3, the earnings amount generally may be allocated in accordance with any of the methods set forth in this paragraph (4). The methods under paragraph (4)(c), (d), and (e) are intended to be particularly helpful where corrective contributions are made at dates between the plan's valuation dates.
- (b) Plan Allocation Method. Under the plan allocation method, the earnings amount is allocated to account balances under the plan in accordance with the plan's method for allocating earnings as if the failure had not occurred. (See Example 22.)
- (c) Specific Employee Allocation Method. Under the specific employee allocation method, the entire earnings amount is allocated solely to the account balance of the employee on whose behalf the corrective contribution or allocation is made (regardless of whether the plan's allocation method would have allocated the earnings solely to that employee). In determining the allocation of plan earnings for the valuation period during which the corrective contribution or allocation is made, the corrective contribution or allocation (including the earnings amount) is treated in the same manner as any other contribution under the plan on behalf of the employee during that valuation period. Alternatively, where the plan's allocation method does not allocate plan earnings for a valuation period to a contribution made during that valuation period, plan earnings for the valuation period during which the corrective contribution or allocation is made may be allocated as if that employee's account balance had been increased as of the last day of the prior valuation period by the corrective contribution or allocation, including only that portion of the earnings amount attributable to earnings through the last day of the prior valuation period. The employee's account balance is then further increased as of the last day of the valuation period during which the corrective contribution or allocation is made by that portion of the earnings amount attributable to earnings after the last day of the prior valuation period. (See Example 23.)
- (d) Bifurcated Allocation Method. Under the bifurcated allocation method, the entire earnings amount for the valuation periods ending before the date the corrective contribution or allocation is made is allocated solely to the account balance of the employee on whose behalf the corrective contribution or allocation is made. The earnings amount for the valuation period during which the corrective contribution or allocation is made is allocated in accordance with the plan's method for

## EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

allocating other earnings for that valuation period in accordance with section 3.01(4)(b). (See Example 24.)

- (e) Current Period Allocation Method. Under the current period allocation method, the portion of the earnings amount attributable to the valuation period during which the period of the failure begins ("first partial valuation period") is allocated in the same manner as earnings for the valuation period during which the corrective contribution or allocation is made in accordance section 3.01(4)(b). The earnings for the subsequent full valuation periods ending before the beginning of the valuation period during which the corrective contribution or allocation is made are allocated solely to the employee for whom the required contribution should have been made. The earnings amount for the valuation period during which the corrective contribution or allocation is made ("second partial valuation period") is allocated in accordance with the plan's method for allocating other earnings for that valuation period in accordance with section 3.01(4)(b). (See Example 25.)

### **.02 EXAMPLES.**

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#### **Example 22:**

Employer L maintains a profit-sharing plan that provides only for nonelective contributions. The plan has a single investment fund. Under the plan, assets are valued annually (the last day of the plan year) and earnings for the year are allocated in proportion to account balances as of the last day of the prior year, after reduction for distributions during the current year but without regard to contributions received during the current year (the "prior year account balance"). Plan contributions for 1997 were made on March 31, 1998. On April 20, 2000 Employer L determines that an operational failure occurred for 1997 because Employee X was improperly excluded from the plan. Employer L decides to correct the failure by using the SVP correction method for the exclusion of an eligible employee from nonelective contributions in a profit-sharing plan. Under this method, Employer L determines that this failure is corrected by making a contribution on behalf of Employee X of \$ 5,000 (adjusted for earnings). The earnings rate under the plan for 1998 was +20%. The earnings rate under the plan for 1999 was +10%. On May 15, 2000, when Employer L determines that a contribution to correct for the failure will be made on June 1, 2000, a reasonable estimate of the earnings rate under the plan from January 1, 2000 to June 1, 2000 is +12%.

Earnings Adjustment on the Corrective Contribution: The \$ 5,000 corrective contribution on behalf of Employee X is adjusted to reflect an earnings amount based

## EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

on the earnings rates for the period of the failure (March 31, 1998 through June 1, 2000) and the earnings amount is allocated using the plan allocation method. Employer L determines that a pro rata simplifying assumption may be used to determine the earnings rate for the period from March 31, 1998 to December 31, 1998, because that rate does not significantly understate or overstate the actual earnings for that period. Accordingly, Employer L determines that the earnings rate for that period is 15% (9/12 of the plan's 20% earnings rate for the year). Thus, applicable earnings rates under the plan during the period of the failure are:

Time Periods	Earnings Rates
3/31/98 - 12/31/98-First Partial Valuation Period	<b>+15%</b>
1/1/99 - 12/31/99	<b>+10%</b>
1/1/00 - 6/1/00 (Second Partial Valuation Period)	<b>+15%</b>

If the \$ 5,000 corrective contribution had been contributed for Employee X on March 31, 1998,

- (1) earnings for 1998 would have been increased by the amount of the earnings on the additional \$ 5,000 contribution from March 31, 1998 through December 31, 1998 and would have been allocated as 1998 earnings in proportion to the prior year (December 31, 1997) account balances,
- (2) Employee X's account balance as of December 31, 1998 would have been increased by the additional \$ 5,000 contribution,
- (3) earnings for 1999 would have been increased by the 1999 earnings on the additional \$ 5,000 contribution (including 1998 earnings thereon) allocated in proportion to the prior year (December 31, 1998) account balances along with other 1999 earnings, and
- (4) earnings for 2000 would have been increased by the earnings on the additional \$ 5,000 (including 1998 and 1999 earnings thereon) from January 1 to June 1, 2000 and would be allocated in proportion to the prior year (December 31, 1999) account balances along with other 2000 earnings.

Accordingly, the \$ 5,000 corrective contribution is adjusted to reflect an earnings amount of \$ 2,084 ( $\$ 5,000[(1.15)(1.10)(1.12)-1]$ ) and the earnings amount is allocated to the account balances under the plan allocation method as follows:

## EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

- (a) Each account balance that shared in the allocation of earnings for 1998 is increased, as of December 31, 1998, by its appropriate share of the earnings amount for 1998, \$ 750 ( $\$ 5,000(.15)$ ).
- (b) Employee X's account balance is increased, as of December 31, 1998, by \$ 5,000.
- (c) The resulting December 31, 1998 account balances will share in the 1999 earnings, including the \$ 575 for 1999 earnings included in the corrective contribution ( $\$ 5,750(.10)$ ), to determine the account balances as of December 31, 1999. However, each account balance other than Employee X's account balance has already shared in the 1999 earnings, excluding the \$ 575. Accordingly, Employee X's account balance as of December 31, 1999 will include \$ 500 of the 1999 portion of the earnings amount based on the \$ 5,000 corrective contribution allocated to Employee X's account balance as of December 31, 1998 ( $\$ 5,000(.10)$ ). Then each account balance that originally shared in the allocation of earnings for 1999 (i.e., excluding the \$ 5,500 additions to Employee X's account balance) is increased by its appropriate share of the remaining 1999 portion of the earnings amount, \$ 75.
- (d) The resulting December 31, 1999 account balances (including the \$ 5,500 additions to Employee X's account balance) will share in the 2000 portion of the earnings amount based on the estimated January 1, 2000 to June 1, 2000 earnings included in the corrective contribution equal to \$ 759 ( $\$ 6,325(.12)$ ). (See Table 1.)



## EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

TABLE 1  
CALCULATION AND ALLOCATION OF THE CORRECTIVE AMOUNT ADJUSTED  
FOR EARNINGS

	Earnings Rate	Amount	Allocated to
Corrective Contribution		<b>\$5,000</b>	<b>Employee X</b>
First Partial Valuation Period Earnings	<b>15%</b>	<b>\$750<sup>1</sup></b>	<b>All 12/31/97 Account Balances <sup>2</sup></b>
1999 Earnings	<b>10%</b>	<b>\$575<sup>3</sup></b>	<b>Employee X (\$500)/ All 12/31/1998 Account Balances (75) <sup>2</sup></b>
Second Partial Valuation Period Earnings	<b>12%</b>	<b>\$759<sup>4</sup></b>	<b>All 12/31/1999 Account Balances (including Employee X's \$5,500) <sup>2</sup></b>
Total Amount Contributed		<b>\$7,084</b>	

### Example 23:

The facts are the same as in Example 22.

Earnings Adjustment on the Corrective Contribution:

The earnings amount on the corrective contribution is the same as in Example 22, but the earnings amount is allocated using the specific employee allocation method. Thus, the entire earnings amount for all periods through June 1, 2000 (i.e., \$ 750 for March 31, 1998 to December 31, 1998, \$ 575 for 1999, and \$ 759 for January 1, 2000 to June 1, 2000) is allocated to Employee X. Accordingly, Employer L makes a contribution on June 1, 2000 to the plan of \$ 7,084 (\$ 5,000(1.15)(1.10)(1.12)). Employee X's account balance as of December 31, 2000 is increased by \$ 7,084. Alternatively, Employee X's account balance as of December 31, 1999 is increased by \$ 6,325 (\$

<sup>1</sup> \$ 5,000 x 15%

<sup>2</sup> After reduction for distributions during the year for which earnings are being determined but without regard to contributions received during the year for which earnings are being determined.

<sup>3</sup> \$ 5,750(\$ 5,000 +750) x 10%

<sup>4</sup> \$ 6,325(\$ 5,000 +750 +575) x 12%

## **EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001**

5,000(1.15)(1.10)), which shares in the allocation of earnings for 2000, and Employee X's account balance as of December 31, 2000 is increased by the remaining \$ 759. (See Table 2.)

## EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

TABLE 2  
CALCULATION AND ALLOCATION OF THE CORRECTIVE AMOUNT ADJUSTED  
FOR EARNINGS

	Earnings Rate	Amount	Allocated to
Corrective Contribution		<b>\$5,000</b>	<b>Employee X</b>
First Partial Valuation Period Earnings	<b>15%</b>	<b>\$7505</b>	<b>Employee X</b>
1999 Earnings	<b>10%</b>	<b>\$5756</b>	<b>Employee X</b>
Second Partial Valuation Period Earnings	<b>12%</b>	<b>\$7597</b>	<b>Employee X</b>
Total Amount Contributed		<b>\$7,084</b>	

### Example 24:

The facts are the same as in Example 22.

Earnings Adjustment on the Corrective Contribution:

The earnings amount on the corrective contribution is the same as in Example 22, but the earnings amount is allocated using the bifurcated allocation method. Thus, the earnings for the first partial valuation period (March 31, 1998 to December 31, 1998) and the earnings for 1999 are allocated to Employee X. Accordingly, Employer L makes a contribution on June 1, 2000 to the plan of \$ 7,084 (\$ 5,000(1.15)(1.10)(1.12)). Employee X's account balance as of December 31, 1999 is increased by \$ 6,325 (\$ 5,000(1.15)(1.10)); and the December 31, 1999 account balances of employees (including Employee X's increased account balance) will share in estimated January 1, 2000 to June 1, 2000 earnings on the corrective contribution equal to \$ 759 (\$ 6,325(.12)). (See Table 3.)

5 \$ 5,000 x 15%

6 \$ 5,750(\$ 5,000 +750) x 10%

7 \$ 6,325(\$ 5,000 +750 +575) x 12%

## EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

TABLE 3  
CALCULATION AND ALLOCATION OF THE CORRECTIVE AMOUNT ADJUSTED  
FOR EARNINGS

	Earnings Rate	Amount	Allocated to
Corrective Contribution		<b>\$5,000</b>	<b>Employee X</b>
First Partial Valuation Period Earnings	<b>15%</b>	<b>\$7508</b>	<b>Employee X</b>
1999 Earnings	<b>10%</b>	<b>\$5759</b>	<b>Employee X</b>
Second Partial Valuation Period Earnings	<b>12%</b>	<b>\$75910</b>	<b>12/31/99 Account Balances (including Employee X's \$6,325)<sup>11</sup></b>
Total Amount Contributed		<b>\$7,084</b>	

### Example 25:

The facts are the same as in Example 22.

Earnings Adjustment on the Corrective Contribution:

The earnings amount on the corrective contribution is the same as in Example 22, but the earnings amount is allocated using the current period allocation method. Thus, the earnings for the first partial valuation period (March 31, 1998 to December 31, 1998) are allocated as 2000 earnings. Accordingly, Employer L makes a contribution on June 1, 2000 to the plan of \$ 7,084 (\$ 5,000 (1.15)(1.10)(1.12)). Employee X's account balance as of December 31, 1999 is increased by the sum of \$ 5,500 (\$ 5,000(1.10)) and the remaining 1999 earnings on the corrective contribution equal to \$ 75 (\$ 5,000(.15)(.10)). Further, both (1) the estimated March 31, 1998 to December 31, 1998 earnings on the corrective contribution equal to \$ 750 (\$ 5,000(.15)) and (2) the estimated January 1, 2000 to June 1, 2000 earnings on the corrective contribution equal to \$ 759 (\$ 6,325(.12)) are treated in the same manner as 2000 earnings by allocating these amounts to the December 31, 2000 account balances of employees in proportion to account balances as of December 31, 1999 (including Employee X's increased account

8 \$ 5,000 x 15%

9 \$ 5,750(\$ 5,000 +750) x 10%

10 \$ 6,325(\$ 5,000 +750 +575) x 12%

11 After reduction for distributions during the 2000 plan year but without regard to contributions received during the 2000 year.

## **EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001**

balance). (See Table 4.) Thus, Employee X is allocated the earnings for the full valuation period during the period of the failure.

## EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

TABLE 4  
CALCULATION AND ALLOCATION OF THE CORRECTIVE AMOUNT ADJUSTED  
FOR EARNINGS

	Earnings Rate	Amount	Allocated to
Corrective Contribution		<b>\$5,000</b>	<b>Employee X</b>
First Partial Valuation Period Earnings	<b>15%</b>	<b>\$75012</b>	<b>Employee X</b>
1999 Earnings	<b>10%</b>	<b>\$57513</b>	<b>Employee X</b>
Second Partial Valuation Period Earnings	<b>12%</b>	<b>\$75914</b>	<b>12/31/99 Account Balances (including Employee X's \$5,575)<sup>15</sup></b>
Total Amount Contributed		<b>\$7,084</b>	

## APPENDIX C

### VCR/SVP/WALK-IN CAP/TVC CHECKLIST

IS YOUR SUBMISSION COMPLETE?

#### INSTRUCTIONS

The Service will be able to respond more quickly to your VCR, SVP, Walk-in CAP or TVC request if it is carefully prepared and complete. To ensure that your request is in order, use this checklist. Answer each question in the checklist by inserting yes, no, or N/A, as appropriate, in the blank next to the item. Sign and date the checklist (as taxpayer or authorized representative) and place it on top of your request.

12  $\$ 5,000 \times 15\%$

13  $\$ 5,750(\$ 5,000 + 750) \times 10\%$

14  $\$ 6,325(\$ 5,000 + 750 + 575) \times 12\%$

15 After reduction for distributions during the year for which earnings are being determined but without regard to contributions received during the year for which earnings are being determined.

## **EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001**

You must submit a completed copy of this checklist with your request. If a completed checklist is not submitted with your request, substantive consideration of your submission will be deferred until a completed checklist is received.

TAXPAYER'S NAME

TAXPAYER'S I.D. NO.

PLAN NAME & NO.

ATTORNEY/P.O.A.

### **THE FOLLOWING ITEMS RELATE TO ALL SUBMISSIONS:**

1. Have you included a complete description of the failure(s) and the years in which the failure(s) occurred (including the years for which the statutory period has expired)? (See section 12.03(1) of Rev. Proc. 2000-16.) (Hereafter, all section references are to Rev. Proc. 2000-16.)
2. Have you included an explanation of how and why the failure(s) arose, including a description of the administrative procedures for the plan in effect at the time the failure(s) occurred? (See section 12.03(2) and (3).)
3. Have you included a detailed description of the method for correcting the failure(s) identified in your submission? This description must include, for example, the number of employees affected and the expected cost of correction (both of which may be approximated if the exact number cannot be determined at the time of the request), the years involved, and calculations or assumptions the Plan Sponsor used to determine the amounts needed for correction. In lieu of providing correction calculations with respect to each employee affected by a failure, you may submit calculations with respect to a representative sample of affected employees. However, the representative sample calculations must be sufficient to demonstrate each aspect of the correction method proposed. Note that each step of the correction method must be described in narrative form. (See section 12.03(4).)
4. Have you described the earnings or interest methodology (indicating computation period and basis for determining earnings or interest rates) that will be used to calculate earnings or interest on any corrective contributions or distributions? (As a general rule, the interest rate (or rates) earned by the plan during the

## **EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001**

applicable period(s) should be used in determining the earnings for corrective contributions or distributions.) (See section 12.03(5).)

If you inserted "N/A" for item 4, enter explanation:

5. Have you submitted specific calculations for each affected employee or a representative sample of affected employees? (See section 12.03(6).)
6. Have you described the method that will be used to locate and notify former employees or, if there are no former employees affected by the failure(s), provided an affirmative statement to that effect? (See section 12.03(7).)
7. Have you provided a description of the administrative measures that have been or will be implemented to ensure that the same failure(s) do not recur? (See section 12.03(8).)
8. Have you included a statement that, to the best of the Plan Sponsor's knowledge, the plan is not currently under an EmployeePlans examination? (See section 12.03(9).)
9. Have you included a statement that, to the best of the Plan Sponsor's knowledge, the Plan Sponsor is not under an Exempt Organizations examination? (See section 12.03(9).)
10. If the plan is currently being considered in a determination letter application on a Form 5310, have you included a statement to that effect? (See section 12.03(10).)
11. Have you included a copy of the portions of the plan document (and adoption agreement, if applicable) relevant to the failure(s) and method(s) of correction? (See section 12.04(3).)
12. Have you included a copy of the plan's most recent Favorable Letter and/or the required applicable document(s)? (See section 12.04(4).)
13. Have you included the appropriate voluntary compliance or correction fee? (See section 12.05.)
14. Have you included the original signature of the sponsor or the sponsor's representative? (See section 12.06.)



## **EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001**

15. Have you included a Power of Attorney (Form 2848)? Note: (representation under the VCR/SVP, Walk-in CAP and TVC is limited to attorneys, certified public accountants, enrolled agents, and enrolled actuaries; unenrolled return preparers are not eligible to act as representatives under the VCR or TVC program). (See section 12.07.)
16. Have you included a Penalty of Perjury Statement signed (original signature only) and dated by the Plan Sponsor? (See section 12.08.)
17. Have you designated your submission as a VCR, SVP, Walk-in CAP, or TVC submission, as appropriate? (See section 12.10.)

### **THE FOLLOWING ITEMS RELATE ONLY TO SUBMISSIONS UNDER VCR (INCLUDING SVP):**

18. Have you included a copy of the first page, the page containing employee census information (currently line 7f of the 1998 Form 5500), and the information relating to plan assets (currently line 31f of the 1998 Form 5500) of the most recently filed Form 5500 series return? Note: If a Form 5500 is not applicable, insert N/A and furnish the name of the plan, and the census information required of Form 5500 series filers. (See section 12.04(1).)
19. Have you proposed a time period of correction that is limited to 150 days from the date the compliance statement is issued? (See section 10.13.)

### **THE FOLLOWING ITEMS RELATE ONLY TO SUBMISSIONS UNDER SVP:**

20. Have you included a statement identifying your request as an SVP request? (See section 12.03(11).)
21. Are each of the failures you have identified eligible for correction under SVP? (See Appendix A and Appendix B.)
22. Have you identified no more than two SVP failures? (If more than two failures were identified, SVP is not available, but you may make a submission under VCR.) (See section 10.11(3).)

## **EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001**

23. Have you proposed to correct the failure(s) identified in your request using the permitted correction method(s) set forth in Appendix A or Appendix B? (See Appendix A and Appendix B.)

### **THE FOLLOWING ITEM RELATES ONLY TO SUBMISSIONS UNDER WALK-IN CAP:**

24. Have you included a copy of the most recently filed Form 5500? (See section 12.04(1).)
25. Have you submitted an application for a determination letter? (See section 11.01(4).)

Signature Date

Title or Authority

Typed or printed name of person signing checklist